Supreme Court, U.S.
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No.

In the Supreme Court of the United States

AMERICAN GENERAL FINANCE, INC., AND
MICHAEL J. ANDERSON,

Petitioners,

v.

MARY JEAN ASHBY,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Alabama

PETITION FOR A WRIT OF CERTIORARI

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110 pp

QUESTIONS PRESENTED

1. Whether, when an arbitration agreement governed by the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, provides that all disputes relating to arbitrability should be decided by an arbitrator, a contention that the arbitration agreement is unenforceable because it is unconscionable nevertheless should be decided by a court.

2. Whether a state-law rule improperly singles out arbitration agreements for unfavorable treatment when it (1) treats the use of broad arbitration clauses as an inherent "indicium of unconscionability" and (2) applies state contract law doctrines differently to arbitration agreements than to other types of contractual agreements.

RULES 14.1 AND 29.6 STATEMENT

The parties to the proceeding in the Alabama Supreme Court were American General Finance, Inc., Merit Life Insurance Co., Michael J. Anderson, and Mary Jean Ashby, personally and as representative of the Estate of Jimmy Ashby.

The ultimate parent company of petitioner American General Finance, Inc., is American International Group, Inc., a publicly traded corporation. No publicly held company other than American International Group, Inc., owns more than 10% of the stock of American General Finance, Inc.

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PETITION FOR A WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the Alabama Supreme Court (App., *infra*, 1a-58a) is not yet reported. The opinion of the Limestone County Circuit Court (App., *infra*, 59a-67a) is not reported.

JURISDICTION

The Alabama Supreme Court's judgment was entered on May 16, 2003. A timely petition for rehearing was denied on August 29, 2003. App., *infra*, 69a. This Court has jurisdiction pursuant to 28 U.S.C. § 1257.

STATUTORY PROVISION INVOLVED

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2, provides:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

STATEMENT

The decision below addressed two important issues arising under the Federal Arbitration Act ("FAA" or "Act"), 9 U.S.C. § 1 *et seq*. The Alabama Supreme Court first held that the question whether an arbitration agreement is unenforceable must be decided by a court rather than an arbitrator, even when the agreement between the parties expressly provides that the *arbitrator* will resolve all issues relating to ar-

bitrability. The court then went on to conclude that the breadth of an arbitration provision is a factor that *itself* tends to establish that the agreement to arbitrate is unconscionable (and therefore unenforceable). These holdings are inconsistent with the decisions of this and other courts, depart from the clear language and purpose of the FAA, and manifest the very sort of hostility to arbitration that the Act forbids. Review of the decision below accordingly is warranted.

1. The FAA establishes a "'liberal federal policy favoring arbitration agreements.'" *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625 (1985) (citation omitted). Section 2 of the Act, 9 U.S.C. § 2, the FAA's "primary substantive provision" (*Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991)), provides that any written agreement to arbitrate in any "contract evidencing a transaction involving commerce * * * shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

There is no doubt about Congress's goal in enacting the FAA. As the Court has explained,

> the basic purpose of the [FAA] is to overcome courts' refusals to enforce agreements to arbitrate. * * * When Congress passed the Arbitration Act in 1925, it was "motivated, first and foremost, by a * * * desire" to change this antiarbitration rule. * * * It intended courts "to enforce [arbitration] agreements into which parties had entered," * * * and to "place such agreements 'upon the same footing as other contracts.'"

Allied-Bruce Terminix Cos. v. *Dobson*, 513 U.S. 265, 270-271 (1995) (citations omitted). See, *e.g.*, *Mitsubishi Motors*, 473 U.S. at 625-626; *Perry* v. *Thomas*, 482 U.S. 483, 490 (1987). To this end, "the federal policy is simply to ensure the enforceability, according to their terms, of private agree-

ments to arbitrate" (*Volt Info. Sci., Inc.* v. *Bd. of Trustees of the Leland Stanford Junior Univ.*, 489 U.S. 468, 476 (1989)) and to "preclude[] States from singling out arbitration provisions for suspect status." *Doctor's Assocs., Inc.* v. *Casarotto*, 517 U.S. 681, 687 (1996).

2. In this case, respondent Mary Jean Ashby and her husband visited the office of petitioner American General Finance, Inc. ("American General") in Athens, Alabama, and obtained a $2000 loan. At the same time, respondent's husband obtained a $5000 life insurance policy from Merit Life Insurance Co. ("Merit Life"), an affiliate of petitioner. App., *infra*, 1a-2a.

The loan agreement contained a detailed arbitration provision specifying that "Borrower(s) and Lender agree that, except as otherwise set forth in this provision, all claims, disputes, or controversies of every kind and nature between Borrower(s) and Lender shall be resolved by arbitration." App., *infra*, 3a. After identifying the subject matter covered by the provision, the arbitration agreement added a so-called "*First Options* clause" (after this Court's decision in *First Options of Chicago, Inc.* v. *Kaplan*, 514 U.S. 938 (1995)) stating that questions regarding arbitrability would be decided by the arbitrator: "Borrower(s) and Lender further agree that all issues and disputes as to the arbitrability of all claims must also be resolved by the arbitrator." App., *infra*, 3a. The arbitration agreement went on to provide that, in the event of a dispute, the arbitrator would not award damages in excess of five times either party's economic loss and that American General retained the right to seek recourse to judicial remedies in certain limited and specific circumstances, such as judicial self-

help remedies to repossess or foreclose on the collateral. App., *infra*, 4a.[1]

Respondent's husband died eight months after the couple received the loan from American General. When respondent filed a claim for death benefits under the credit life insurance policy, Merit Life declined to pay, stating that respondent's husband had given inaccurate answers to questions about his health at the time that he obtained the insurance. Respondent then brought this action in Alabama state court against American General, Merit Life, and Michael Anderson (American General's branch manager in Athens), alleging fraud, conspiracy, breach of contract, negligence, and bad faith refusal to pay. Invoking the arbitration clause, the defendants moved to stay the proceedings and compel arbitration. Respondent opposed the motion, arguing, in relevant part, that the arbitration agreement was unconscionable and therefore unenforceable under Alabama law. App., *infra*, 8a.

The trial court ruled for respondent, denying the motion to stay the litigation and compel arbitration. App., *infra*, 59a-67a. Notwithstanding the *First Options* clause in the arbitration agreement, the court first held that "[t]he defense of unconscionability must be addressed by the trial court." *Id.* at 62a. Relying on the Alabama Supreme Court's decision in *American General Finance, Inc.* v. *Branch*, 793 So. 2d 738 (Ala. 2000), cert. denied, 534 U.S. 949 (2001), which invalidated an arbitration clause identical to the one at issue in this

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[1] Respondent has very limited reading ability and her husband allegedly was illiterate. App., *infra*, 2a. Petitioner Michael Anderson, American General's branch manager in Athens, accordingly explained the loan documents to the couple. *Ibid.* Although the parties disagreed about whether Mr. Anderson specifically explained the arbitration provision in the loan agreement (see *id.* at 7a), the court below did not premise its holding on his purported failure to do so.

case, the trial court then held that the arbitration provision in the loan agreement is unconscionable because it is "grossly favorable" to American General, which had "overwhelming bargaining power" when the agreement was consummated. App, *infra*, 62a-66a.[2]

3. The Alabama Supreme Court affirmed. App., *infra*, 1a-58a. The court began by rejecting American General's argument "that because the parties had agreed that issues of arbitrability were to be decided by the arbitrator, the trial court had no authority to address the issue of unconscionability." *Id.* at 11a. See *id.* at 10a. Reaffirming the reasoning in its earlier *Branch* decision, the court stated:

> "'[A] determination that, by the terms of the arbitration clause, the arbitrator is to decide issues of arbitrability, does not end the inquiry.' 'Where the attack is addressed to the arbitration clause itself, as opposed to the contract as a whole, the court, and not the arbitrator, resolves the issue.' Thus, the threshold 'issue of unconscionability of an *arbitration clause* is a question for the court and not the arbitrator.'"

Id. at 11a (citations omitted; emphasis in original). The court therefore held that, because respondent "contends that the

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[2] The trial court took a different approach in resolving the claims against Merit Life. Although respondent's husband had executed an arbitration agreement in connection with his insurance contract, that agreement appeared in a "separate contract document." App., *infra*, 67a. Respondent contended that the company misrepresented the nature of this document to her husband, a claim that the court understood to be an allegation of "fraud in the factum or execution." *Id.* at 66a. Because this argument raised doubts about whether respondent's husband agreed to arbitration, the court held that the claim of fraud had to be settled at trial. *Id.* at 67a. The Alabama Supreme Court affirmed this ruling. *Id.* at 23a-30a. The petition does not challenge that aspect of the decision below.

arbitration agreement included in the note and security agreement was itself unconscionable, the trial court did not err in holding that it had authority to resolve that issue." *Ibid.*

The Alabama Supreme Court then turned to the merits of respondent's contention that the arbitration clause is unconscionable. The court held that Alabama's unconscionability doctrine requires a party challenging a contract to show that the provision at issue is (1) "grossly favorable" (2) to a party that had "overwhelming bargaining power." In the court's view, both elements of this test were satisfied here.

As to the first prong of the unconscionability test, the court identified four provisions of the arbitration agreement that it deemed "grossly favorable" to American General:

> Those provisions grossly favorable to American General Finance are: (1) the breadth of the arbitration agreement, which extends to every cause of action that might conceivably arise in favor of [respondent] and that applies to every individual or entity against whom [she] might bring a claim; (2) the provision purporting to invest the arbitrator with [authority to decide] the threshold issue of arbitrability; (3) the provision reserving to American General Finance the right to a trial by jury while mandating that [respondent] arbitrate any and every claim that might arise; and (4) the provision limiting [respondent's] right of recovery for all species of damages to five times the economic loss while preserving American General Finance's right to seek full redress for its claims.

App., *infra*, 16a.[3]

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[3] The court's characterization of American General's alleged right to a jury trial and "to seek full redress for its claims" did not accurately describe the agreement. See page 3, *supra*; App., *infra*, 3a-4a.

Turning to the second prong of its test, the Alabama Supreme Court looked to the practices of lenders that advertised in the yellow pages of the Athens, Alabama, telephone directory. App., *infra*, 17a. Because the court believed the evidence showed that most of these companies required borrowers to execute arbitration agreements, and because respondent had no input into drafting the arbitration agreement here, the court held that respondent "had no meaningful choice in accepting the arbitration agreement and * * * American General Finance had overwhelming bargaining power." App., *infra*, 18a-19a, 21a. With both elements of its test thus satisfied, the court concluded that "the arbitration agreement in this case is unconscionable in numerous aspects." *Id.* at 22a. Moreover, although the agreement contained a severability clause (see *id.* at 5a), the court held that the "entire arbitration agreement" should be treated as "unconscionable and therefore unenforceable." *Id.* at 23a.[4]

Three Justices dissented from various aspects of the decision in separate opinions. App., *infra*, 33a-58a. Justice See was of the view that, "[i]f the parties agreed in the arbitration agreement that the arbitrator shall decide questions of arbitrability – what is called a *First Options* clause – then with the exception of whether the parties actually agreed to a *First Options* clause, an arbitrator should decide all questions of procedural and substantive arbitrability." *Id.* at 44a. As a consequence, Justice See concluded that, "[b]ecause the arbitration agreement in this case contains a *First Options* clause, the trial court erred when it considered the question whether

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[4] Although the court remanded the case for a trial on the merits of respondent's claims against petitioners and for resolution of her allegation of fraud against Merit Life (see note 2, *supra*), the decision below plainly is final for purposes of 28 U.S.C. § 1257. See *Southland Corp.* v. *Keating*, 465 U.S. 1, 6-8 (1984).

the arbitration clause in the loan agreement was unconscionable." *Id.* at 47a.

Justice See also took issue with the majority's unconscionability analysis. He maintained that "[a] clause that requires parties to submit a dispute about the arbitrability of their dispute to the arbitrator cannot be unconscionable," explaining that "[t]o hold otherwise would impermissibly 'single out the provisions of arbitration agreements for suspect status.'" App., *infra*, 51a (citation omitted). In reality, he concluded, the majority opinion held that "the arbitration agreement in American General Finance's loan agreement is unconscionable, not because the parties agree to limit available remedies, but because the limited remedies are to be determined in an arbitral forum in which threshold questions of arbitrability are to be determined by the arbitrator. That result is not permitted by the Federal Arbitration Act." *Id.* at 55a.[5]

REASONS FOR GRANTING THE PETITION

The Alabama Supreme Court's decision reflects, in undiluted form, the very "'judicial hostility to arbitration agreements'" (*Shearson/American Express, Inc.* v. *McMahon*, 482 U.S. 220, 225 (1987) (citation omitted)) that Congress sought to root out when it enacted the FAA. Although the contract here expressly specifies that "all issues and disputes as to the arbitrability of claims must * * * be resolved by the arbitra-

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[5] Justice Brown agreed with Justice See's latter point, dissenting on the ground that "the majority opinion impermissibly 'single[s] out the provisions of [the] arbitration agreement[] for suspect status' and places the arbitration agreement on a different footing than other contracts." App., *infra*, 33a (citation omitted). Justice Stuart dissented on the separate ground that the arbitration agreement should not have been found unconscionable absent evidence that respondent had made an unsuccessful "attempt to secure an arbitration-free loan." *Id.* at 34a.

tor," the court held that challenges to the enforceability of the arbitration clause should, instead, be decided by a judge. And while the Act provides that an arbitration clause must be enforced "save upon such grounds as exist at law or in equity for the revocation of any contract," the court held that the use of contract language specifically relating to arbitration is *itself* an indicium of contract unconscionability.

Those holdings are inconsistent with the unambiguous teachings of this Court and at odds with the clear meaning of the Act. They cannot be reconciled with the decisions of federal courts of appeals and other state courts of last resort. They threaten to undermine the important federal policies expressed in the FAA. And they create confusion and uncertainty about the rules governing an often-recurring issue that the Court has recognized to have considerable "practical importance." *First Options*, 514 U.S. at 942. Further review therefore is appropriate.

I. THE COURT BELOW ERRED IN REFUSING TO ENFORCE A CONTRACT PROVISION EXPRESSLY PROVIDING THAT THE ARBITRATOR SHOULD RESOLVE CHALLENGES TO ARBITRABILITY

A. The Alabama Supreme Court's Holding Cannot Be Reconciled With This Court's Decisions

1. At the outset, the Alabama Supreme Court's ruling cannot be reconciled with this Court's decisions explaining who is responsible for resolving the question of arbitrability. The court below held that, whenever the validity of an arbitration clause is challenged, "the court, and not the arbitrator, resolves the issue" – even when, "*by the terms of the arbitration clause, the arbitrator is to decide issues of arbitrability.*" App., *infra*, 11a (citations and internal quotation marks omitted; emphasis added). But this Court has announced precisely the opposite rule, declaring unambiguously that "a

court must defer to an *arbitrator's* arbitrability decision when the parties submitted that matter to arbitration." *First Options*, 514 U.S. at 943 (emphasis added).[6]

As the Court has explained, the question of who is to decide arbitrability "is fairly simple" and "turns upon what the parties agreed about that matter." *First Options*, 514 U.S. at 942, 943. If the contract is *silent or ambiguous* on the question, a court should decide whether the arbitration agreement is enforceable so as avoid the risk of "forc[ing] unwilling parties to arbitrate a matter they reasonably would have thought a judge, not an arbitrator, would decide." *Id.* at 945. Where the contract does not clearly address the question who resolves questions of arbitrability,

> contracting parties would likely have expected a court to have decided the gateway matter [of arbitrability]. * * * [T]hey are not likely to have thought that they had agreed that an arbitrator would do so, and, consequently, * * * reference of the gateway dispute to the court avoids the risk of forcing parties to arbitrate a matter that they may well not have agreed to arbitrate.

Howsam v. *Dean Witter Reynolds, Inc.*, 537 U.S 79, 83-84 (2002). See *Pacificare Health Sys., Inc.* v. *Book*, 123 S. Ct.

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[6] Although state law provides the tools for contract interpretation, "whether a court or arbitrator is to decide particular issues is not a question of contract law, but is instead governed by the FAA; it is a federal law issue to be decided under the 'body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the [FAA].'" *Anders* v. *Hometown Mortgage Servs., Inc.*, 346 F.3d 1024, 1033 (11th Cir. 2003) (quoting *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

1531, 1536 n.2 (2003); *Green Tree Fin. Corp* v. *Bazzle*, 123 S. Ct. 2402, 2407 (2003) (plurality opinion).[7]

A different outcome is required, however, when – as in this case – "the parties agree[d] to submit the arbitrability question itself to arbitration." *First Options*, 514 U.S. at 943. The Court thus consistently has stated that an *arbitrator* must decide questions of arbitrability when the terms of the arbitration agreement contain "a clear demonstration of that purpose." *United Steelworkers of Am.* v. *Warrior & Gulf Navigation Co.*, 363 U.S. 574, 583 n.7 (1960). See *First Options*, 514 U.S. at 944 (arbitrator decides arbitrability when "there is 'clea[r] and unmistakabl[e]' evidence" that the parties agreed to give that power to the arbitrator) (quoting *AT&T Techs., Inc.* v. *Communications Workers of Am.*, 475 U.S. 643, 649 (1986)); *Bazzle*, 123 S. Ct. at 2407 (plurality opinion) (same); *Howsam*, 537 U.S. at 83 (same). This rule is compelled by the command of the FAA, whose "basic objective" is "to ensure that commercial arbitration agreements, like other contracts, *are enforced according to their terms.*" *First Options*, 514 U.S. at 947 (citations and internal quotation marks omitted; emphasis added). See, *e.g.*, *Mastrobuono* v. *Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53-54 (1995); *Howsam*, 537 U.S. at 87 (Thomas, J., concurring in the

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[7] The rule that the court should decide "gateway" questions of arbitrability when the contract is silent as to who is to resolve such issues is a reversal of the usual rule that governs disputes about the scope of arbitration clauses: in the latter set of cases, "there is a presumption of arbitrability in the sense that '[a]n order to arbitrate the particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage.'" *AT&T Techs., Inc.* v. *Communications Workers of Am.*, 475 U.S. 643, 650 (1986) (citation omitted). See, *e.g.*, *Howsam*, 537 U.S. at 84-86; *First Options*, 514 U.S. at 944-945.

judgment); *Shearson/American Express, Inc.* v. *McMahon*, 482 U.S. 220, 226 (1987) ("The Arbitration Act * * * establishes a 'federal policy favoring arbitration,' * * * requiring that 'we rigorously enforce agreements to arbitrate.'") (citations omitted).

2. Arbitral resolution of a threshold question of arbitrability is not rendered inappropriate here simply because a successful challenge would result in the arbitrator's determining that the arbitration agreement is unenforceable. That conclusion follows directly from the Court's decision in *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402 (1967), which held that an arbitrator, and not a court, should resolve an allegation of "fraud in the inducement of the contract." See *Perry* v. *Thomas*, 482 U.S. 483, 491 n.8 (1987); *Southland Corp.* v. *Keating*, 465 U.S. 1, 11 (1984); *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983); *Sphere Drake Ins. Ltd.* v. *All Am. Ins. Co.*, 256 F.3d 587, 590 (7th Cir. 2001). *Prima Paint* indicated that a court may decide a claim that a party was fraudulently induced to sign "the arbitration clause itself" because that issue "goes to the '*making*' of the agreement to arbitrate." 388 U.S. at 404 (emphasis added). But the Court went on to hold that the FAA "does not permit the federal court to consider claims of fraud in the inducement of the contract as a whole" (*id.* at 405) – even though such a claim, if accepted, would result in the invalidation of the entire contract, including the arbitration clause, and therefore would deprive the arbitrator of further authority in the case.

As Judge Easterbrook wrote for the Seventh Circuit, it was crucial in *Prima Paint* that "[t]here was no doubt that the arbitration agreement (and the contract of which it was a part) had been signed; both sides knew what they were getting." *Sphere Drake*, 256 F.3d at 590. Distinguishing claims that the underlying contract had never been signed *at all* from

those alleging that a signed contract is unenforceable, he added:

> Fraud in the inducement does not negate the fact that the parties actually reached an agreement. That's what was critical in *Prima Paint*. But whether there was *any* agreement is a distinct question. * * * This is not a defense to enforcement, as in *Prima Paint*; it is a situation in which no contract came into being * * *. It was possible to arbitrate in *Prima Paint* without circularity; in forgery and agency cases, by contrast, the arbitrator's authority to resolve the dispute would depend on one particular answer to that very dispute. Only a court can break that circle.

Id. at 590-591. Under *Prima Paint* and the Court's subsequent decisions, then, the dispositive question is whether the parties agreed that the issue of arbitrability would be submitted to the arbitrator. See *id.* at 591 (citing *First Options*, "the parties may agree separately to arbitrate disputes about whether they have agreed to the contract's substantive terms"). Once "[h]aving made the bargain to arbitrate, the part[ies] should be held to it." *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985).[8]

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[8] Indeed, in *First Options* itself, the parties seeking to avoid arbitration contended that they were not bound by the arbitration agreement because, although an entity with which they were associated had signed the agreement, they themselves had not. See 514 U.S. at 941. If accepted, that argument would have meant that the arbitration clause was unenforceable as to those parties. But the Court did *not* find that factor relevant to its analysis of who should decide arbitrability. Instead, the Court ultimately held that a judge should decide the question of arbitrability in *First Options* only after it examined the arbitration agreement and concluded that the party seeking to compel arbitration could "[]not show that the [opposing party] clearly agreed to have the arbitrators decide (*i.e.*, to

Accordingly, as Justice See correctly recognized in his dissent below, "[be]cause the arbitration agreement in this case contains a *First Options* clause, the trial court erred when it considered the question whether the arbitration clause in the loan agreement was unconscionable." App., *infra*, 47a. The contract here "clearly and unmistakably provide[s]" (*AT&T Techs.*, 475 U.S. at 649) that "all issues and disputes as to the arbitrability of claims must * * * be resolved by the arbitrator." App., *infra*, 3a. The Alabama Supreme Court did not suggest otherwise, nor did it base its decision on any suggestion that respondent failed to appreciate what she was signing when she entered into the contract.[9] Instead, the court flatly rejected the legal proposition that, "because the parties had agreed that issues of arbitrability were to be decided by the arbitrator, the trial court had no authority to address the issue of unconscionability." App., *infra*, 11a. Starting from the premise that "'the doctrine of unconscionability [is] a defense to enforcement of a contract'" (*id.* at 10a (citation omitted)), the court held: "Because [respondent] contends that the arbitration agreement included in the note and security agreement was itself unconscionable, the trial court did not err in holding that it had the authority to resolve that issue." *Id.* at 11a. That holding conflicts with this Court's decisions in *First Options* and *Prima Paint* and ignores "the federal policy 'to ensure the enforceability, according to their terms, of private agreements to arbitrate.'"

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arbitrate) the question of arbitrability." *Id.* at 946. Here, of course, the arbitration agreement contains the very sort of express *First Options* clause that was missing from the arbitration contract at issue in *First Options*.

[9] In marked contrast, the court held that a trial was necessary to determine whether respondent's husband was aware that he had signed an arbitration clause in connection with his separate insurance contract. See App., *infra*, 23a n.9, 23a-30a.

Mastrubuono, 514 U.S. at 57 (quoting *Volt Info. Sci., Inc.* v. *Bd. of Trustees of the Leland Stanford Junior Univ.*, 479 U.S. at 476).

B. The Alabama Supreme Court's Holding Conflicts With The Decisions Of Federal Courts Of Appeals

Given the clarity of this Court's determination that *First Options* clauses must be enforced, it is not surprising that the contrary holding below conflicts with the decisions of numerous federal courts of appeals. Those courts consistently have held that contractual provisions assigning to the arbitrator the authority to determine questions of arbitrability must be enforced as written, even when the party challenging arbitrability argues that the arbitrator lacks the authority to resolve the dispute.

In *Apollo Computer, Inc.* v. *Berg*, 886 F.2d 469 (1st Cir. 1989), for example, the plaintiff sought to avoid arbitration, arguing that "there was no agreement to arbitrate between it and the defendants" because the arbitration agreement had terminated and was otherwise invalid. *Id.* at 470. The parties' contract provided, however, that all disputes "would be settled by binding arbitration 'in accordance with the rules of the International Chamber of Commerce ["ICC"],'" and those rules stated that when there is "prima facie existence of [an arbitration] agreement," "any decision as to the arbitrator's jurisdiction shall be taken by the arbitrator." *Id.* at 473. The First Circuit therefore found that the contract "delegates to the arbitrator decisions about the arbitrability of disputes involving the existence and validity of a *prima facie* agreement to arbitrate." *Ibid.* In these circumstances, the court held:

> Ordinarily, [the plaintiff] would be entitled to have these issues resolved by a court. * * * By contracting to have all disputes resolved according to the Rules of the ICC, however, [the plaintiff] agreed to be bound by [the rules

> allowing the arbitrator to determine arbitrability]. * * * The arbitrator should decide whether a valid arbitration agreement exists between [the plaintiff] and the defendants.

Ibid. See *id.* at 472. The Second Circuit reached an identical conclusion in *Shaw Group, Inc.* v. *Triplefine International Corp.*, 322 F.3d 115 (2d Cir. 2003), holding that contractual reference to the ICC rules constituted an enforceable *First Options* clause; although the court recognized that doubts about "who should decide arbitrability" generally should have "judicial rather than arbitral resolution" (*id.* at 120), it held that the express contractual language "manifests the parties' clear and unmistakable intent to submit questions of arbitrability to arbitration." *Id.* at 121. See *id.* at 118.[10]

Similarly, in *FSC Securities Corp.* v. *Freel*, 14 F.3d 1310 (8th Cir. 1994), the parties incorporated into their contract a clause providing that "'[t]he arbitrator shall be empowered to interpret *and determine the applicability* of all provisions under [the NASD] Code [of Arbitration Procedures].'" *Id.* at 1312 (emphasis added). When one of the parties to the contract subsequently sought arbitration of a dispute under the NASD Code, the other maintained that arbitration was precluded by the Code's six-year time limit. *Id.* at 1311-1312. The Eighth Circuit assumed that this limit "is not merely a procedural 'statute of limitation,' which would be left to the arbitrators' interpretive discretion – but rather a substantive limitation on what disputes are 'eligible for submission' to

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[10] Wholly apart from the rules of the ICC, the Second Circuit in *Shaw* found that "even absent an express contractual commitment of the issue of arbitrability to arbitration, [the contract's] referral of 'any and all' controversies [to the arbitrator] reflects such a 'broad grant of power to the arbitrators' as to evidence the parties' clear 'inten[t] to arbitrate issues of arbitrability.'" 322 F.3d at 121 (citation omitted).

the arbitrators in the first instance." *Id.* at 1312.[11] Given the "'clear and unmistakable' expression of [the parties'] intent to leave the question of arbitrability to the arbitrators" (*id.* at 1312-1313), the court held that the threshold question of arbitrability had to be resolved by the arbitrator and not the court. *Ibid.* See also *Painewebber Inc.* v. *Bybyk*, 81 F.3d 1193 (2d Cir. 1996); *Baily* v. *Ameriquest Mortgage Co.*, 346 F.3d 821, 824 (8th Cir. 2003).[12]

In *United Food and Commercial Workers Union* v. *Lucky Stores, Inc.*, 806 F.2d 1385 (9th Cir. 1986), the contract between the parties provided that, "[i]f a question of the arbitrability of an issue is raised by either party, such question shall be determined in the first instance by the arbitrator." *Id.* at 1386. When one party nevertheless insisted that the court should decide the question of arbitrability, the Ninth Circuit, in an opinion by Judge Kozinski, responded: "Some such issues of arbitrability can be decided by the courts. But the parties are free to provide otherwise and, where they do, there is no room for a court to get involved." *Id.* at 1386 (citing *Steelworkers*, 363 U.S. at 591 (Brennan, J., concurring)).

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[11] This Court subsequently held in *Howsam* that the question of compliance with the NASD rules' time limit "closely resembles the gateway questions that this Court has found not to be 'questions of arbitrability'" and therefore should be resolved by an arbitrator even in the absence of a *First Options* clause. 537 U.S. at 84-85 (citation omitted).

[12] In addition to the express *First Options* clause quoted at App., *infra*, 3a, the arbitration agreement in this case contains an additional provision almost identical to the one found dispositive in *Apollo Computer* and *FSC Securities*. It incorporated by reference the Commercial Rules of the American Arbitration Association. See R. 113. Rule 8(a) (emphasis added) of those rules grants the arbitrator the power to resolve "the existence, scope or *validity* of the arbitration agreement."

The court added that accepting the contrary argument would effectively render such issues of arbitrability "incapable of being committed to arbitrat[ors]. * * * In effect, we would be carving out an area where the parties cannot avoid court involvement." *Ibid.*

In *Washington-Baltimore Newspaper Guild* v. *Washington Post*, 959 F.2d 288 (D.C. Cir. 1992), the contract provided that "'[a] grievance, * * * *including any question whether a grievance is arbitrable*, * * * may be submitted to arbitration by the moving party.'" *Id.* at 291 (ellipses and emphasis in original). Rejecting an argument that the court should resolve the question of arbitrability, the D.C. Circuit explained that the issue "[n]ormally" should be addressed by a judge, but "[t]he parties may * * * avoid this judicial determination by 'clearly and unmistakably provid[ing] otherwise.'" *Ibid.* (quoting *AT&T Techs.*, 475 U.S. at 649). The court of appeals held that the controlling contract did just that, "emphasiz[ing] for district courts that in similar cases * * * there is no need or purpose in determining arbitrability." *Id.* at 292.

These decisions properly applied this Court's holdings on who is to determine arbitrability; the decision below did not. This disagreement confirms that the Alabama Supreme Court is out of step with the controlling rules in this area. That divergence in approach is of particular practical importance because it will result in identical arbitration agreements receiving dissimilar treatment depending upon where disputes arise. The Court should intervene to resolve this conflict.

II. THE ALABAMA SUPREME COURT'S DECISION SINGLES OUT ARBITRATION CONTRACTS FOR UNIQUELY UNFAVORABLE TREATMENT, AN APPROACH THAT IS INCONSISTENT WITH THE HOLDINGS OF THIS AND OTHER COURTS

Review of the decision below also is appropriate for a second, independent reason. Even assuming that the Alabama Supreme Court was entitled to address the question of arbitrability, that court went fatally astray in holding that the arbitration clause at issue is invalid as unconscionable. In reaching that conclusion, the court used an approach that subjects arbitration contracts to a unique and unfavorable rule – an outcome that is inconsistent with the plain terms of the FAA, that cannot be reconciled with the holdings of this and other courts, and that threatens to frustrate the central goal of the federal law.

1. Section 2 of the FAA provides that arbitration provisions must be enforced, "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Looking to this language, the Court has recognized that "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements." *Doctor's Assocs., Inc.* v. *Casarotto*, 517 U.S. 681, 686-687 (1996). At the same time, however, the Court has emphasized that

> [c]ourts may not * * * invalidate arbitration agreements under state laws applicable only to arbitration provisions. By enacting § 2, we have several times said, Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed "upon the same footing as other contracts."

Id. at 687 (quoting *Scherck* v. *Alberto-Culver Co.*, 417 U.S. 506, 511 (1974)).

Under this principle, the Court repeatedly has invalidated state rules that have the effect of according arbitration provisions uniquely unfavorable treatment: "'A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with [the text of § 2].'" *Doctor's Assocs.*, 517 U.S. at 685 (quoting *Perry*, 482 U.S. at 492 n.9 (brackets added by the Court)). See *id.* at 683; *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. at 281; *Southland Corp.* v. *Keating*, 465 U.S. 1, 16 n.11 (1984). Not surprisingly, federal courts of appeals and state courts of last resort have done the same. See, *e.g.*, *Bradley* v. *Harris Research, Inc.*, 275 F.3d 884, 890 (9th Cir. 2001) (state law may not govern arbitration provisions when it applies only to forum selection clauses in franchise agreements and therefore "does not apply to 'any contract'" as required by FAA § 2); *OPE Int'l, LP* v. *Chet Morrison Contractors, Inc.*, 258 F.3d 443, 443-444 (5th Cir. 2001) (state law preempted when it conditions arbitration agreement on use of in-state arbitral forum, a limitation directed specifically at arbitration provisions); *Doctor's Assocs., Inc.* v. *Hamilton*, 150 F.3d 157, 163 (2d Cir. 1998) (state law preempted as to arbitration clause when it applies only "to one sort of contract provision (forum selection) and one type of contract (a franchise agreement)"), cert. denied, 525 U.S. 1103 (1999); *Heaberlin Farms, Inc.* v. *IGF Ins. Co.*, 641 N.W.2d 816, 819 (Iowa 2002) (state law preempted as to arbitration agreements because it does not apply to all contracts).

2. a. For several reasons, the Alabama Supreme Court's decision cannot be reconciled with this principle. First, and most obviously, critical elements of the unconscionability analysis used below are uniquely applicable to arbitration contracts. The court thus held that a "provision purporting to invest the arbitrator with [the authority to decide] the threshold issue of arbitrability" inherently is "grossly favorable" to the party seeking arbitration (App.,

infra, 16a); indeed, under the prior Alabama decision that the court below held to be controlling in this case, "'[s]uch authority of the arbitrator to determine its own authority may *itself* be an indicium of unconscionability.'" *Branch*, 793 So. 2d at 749 (emphasis added). Similarly, the Alabama court identified "the breadth of the arbitration agreement, which extends to every cause of action that might conceivably arise in favor of [respondent]," as a "grossly favorable" contract term that serves as a separate indicium of unconscionability. App., *infra*, 16a. See also *Branch*, 793 So. 2d at 748-749.

On the face of it, this analysis can apply only to arbitration contracts; it expressly ties the determination of unconscionability to the presence of particular language that could appear *only in an arbitration clause*. See App., *infra*, 52a (See, J., dissenting) ("A rule that states it is unconscionable for parties to agree to submit disputes about arbitrability to an arbitrator is a rule that necessarily applies only to arbitration clauses and therefore runs afoul of the holding in *Doctor's Associates*."). As such, it surely "singl[es] out arbitration provisions for suspect status" and establishes a rule that is preempted by Section 2 of the FAA. As we have noted, "[t]he 'goals and policies' of the FAA * * * are antithetical to threshold limitations placed specifically and solely on arbitration provisions." *Doctor's Assocs.*, 517 U.S. at 682, 688. "Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." *Perry*, 482 U.S. at 492 n.9. But that is just what the Alabama Supreme Court did here.

b. Second, the decision below, which treats *First Options* clauses and broad arbitration agreements as indicia of unconscionability, necessarily is premised on the assumption that such provisions are inherently overbearing and inequitable to one of the contracting parties. That proposition "is pervaded by what Judge Jerome Frank called 'the old judicial hostility to arbitration.'" *Rodriguez de Quijas* v. *Shearson/American*

Express, Inc., 490 U.S. 477, 480 (1989). A doctrine that treats broad arbitration provisions and *First Options* clauses as suspect surely "'res[ts] on suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants.'" *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 30 (1991) (quoting *Rodriguez de Quijas*, 490 U.S. at 481). But that suspicion is wrong as an empirical matter[13] and impermissible as a basis for a legal rule. The FAA "seeks broadly to overcome judicial hostility to arbitration agreements" (*Allied-Bruce Terminix*, 513 U.S. at 272), and "[w]e are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution." *Mitsubishi*, 473 U.S. at 626-627. For this reason,

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[13] There is considerable empirical evidence that individuals fare better in arbitration than in litigation, in both the employment and non-employment contexts. See Mogilnicki & Jensen, *Arbitration and Unconscionability*, 19 GA. ST. U. L. REV. 761, 763-765 (2003). And commentators agree that the speed and lower cost of arbitration is of special benefit to low- and middle-income individuals. See, *e.g.*, *id.* at 765-772; Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO ST. J. ON DISP. RESOL. 777, 803, 818, 822 (2003); Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 55-58, 63 (1998). See generally *Allied-Bruce Terminix*, 513 U.S. at 280 ("arbitration's advantages often would seem helpful to individuals, say, complaining about a product, who need a less expensive alternative to litigation. See, *e.g.*, H.R. Rep. No. 97-542, p. 13 (1982) ('the advantages of arbitration are many: it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling times and places of hearings and discovery devices …')").

treating the adoption of *First Options* clauses and broadly written arbitration requirements as inherent indicia of unconscionability is "'far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes.'" *Gilmer*, 500 U.S. at 30 (quoting *Rodriguez de Quijas*, 490 U.S. at 481). See generally *Green Tree Fin. Corp.-Alabama* v. *Randolph*, 531 U.S. 79, 89-91 (2000).

Indeed, the Alabama Supreme Court's approach is fundamentally at odds with the policies that underlie the Act. The FAA was enacted for the express purpose of encouraging the widest possible use of arbitration. This Court has said time and again that the Act put in place a "federal policy favoring arbitration" (*Mastrobuono*, 514 U.S. at 62) – so much so that "'[t]he Act establish[ed] that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration'" (*Mitsubishi*, 473 U.S. at 626 (quoting *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 24-25)), and the contracting parties' intentions must be "generously construed as to issues of arbitrability." *Ibid.* See, *e.g.*, *Pacificare Health Sys., Inc.* v. *Book*, 123 S. Ct. 1531, 1536 n.2 (2003); *Bazzle*, 123 S. Ct. at 2407 (plurality opinion); *Gilmer*, 500 U.S. at 26; *Rodriguez de Quijas*, 490 U.S. at 479-480. Section 2 of the FAA sought to effectuate this policy both by generally mandating the enforcement of arbitration clauses and by placing arbitration agreements on the same footing as other contracts. See *Allied-Bruce Terminix*, 513 U.S. at 281.[14]

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[14] Congress has since reaffirmed the federal policy favoring arbitration in other contexts, noting that arbitral resolution of disputes helps avoid the "delays, expense, uncertainties, loss of control, adverse publicity, and animosities that frequently accompany litigation." Y2K Act, Pub. L. No. 106-37, § 2(a)(3)(B)(iv), 106 Stat. 185.

Treating *First Options* clauses and broad arbitration provisions as "indicia of unconscionability," however, directly penalizes the use of such provisions and inevitably discourages their inclusion in arbitration contracts. The Alabama court's interpretive approach therefore restricts a method of dispute resolution that Congress sought to encourage through the "liberal federal policy favoring arbitration agreements." *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 24. This tension with federal law is manifest: although Congress mandated use of an interpretive approach that gives arbitration provisions the widest possible scope, the Alabama court adopted a rule under which the broader the arbitration agreement, the more likely it is to be invalidated.

c. Third, other aspects of the decision below also apply state contract law in extraordinary and atypical ways – an approach that, it seems plain, again was premised on hostility to arbitration. This approach, which "distort[ed] the process of contract interpretation" to the disadvantage of arbitration agreements (*Mitsubishi*, 473 U.S. at 627), cannot be squared with the FAA.

Thus, the Alabama Supreme Court found it an additional indicium of unconscionability here that the arbitration clause in some instances "reserv[ed] to [American General] the right to a trial by jury while mandating that the [plaintiffs] arbitrate any and every claim." App., *infra*, 16a; see also *Branch*, 793 So. 2d at 749 ("absence of mutuality of remedy is still relevant in an unconscionability analysis"). As a general matter, however, mutuality of remedy is *not* a requirement for enforceability of a contract in Alabama. See, *e.g.*, *Marcrum* v. *Embry*, 282 So. 2d 49, 51 (Ala. 1973); App., *infra*, 52a (See, J., dissenting).[15]

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[15] Numerous courts across the country have held that an arbitration clause contained in a consumer contract "need not be supported by

Similarly, the court below held that American General had "overwhelming bargaining power" – establishing the second prong of its unconscionability analysis – because respondent would have had difficulty finding a local lender that would not "have insisted that the [respondent] sign an arbitration agreement." App., *infra*, 19a; see *id.* at 17a-18a. But the notion that the prevalence of a contractual term in the marketplace tends to establish its invalidity has never been an element of Alabama law outside the arbitration context; to the contrary, the Alabama Supreme Court has held that, when a contractual provision has become "widely used and accepted in a particular trade," there is "a prima facie case that the usage is *reasonable*." *Fleming Farms* v. *Dixie Ag Supply, Inc.*, 631 So. 2d 922, 926 (Ala. 1994) (emphasis added). Were that not so, the presence of any of the hundreds of standard clauses used in contracts every day would go a long

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equivalent obligations" to be enforceable. *Harris* v. *Green Tree Fin. Corp.*, 183 F.3d 173, 180-181, 183 (3d Cir. 1999) (collecting federal and state cases). See also, *e.g.*, *Fazio* v. *Lehman Bros. Inc.*, 340 F.3d 386 (6th Cir. 2003); *Bess* v. *Check Express*, 294 F.3d 1298, 1308 (11th Cir. 2002); *We Care Hair Dev., Inc.* v. *Engen*, 180 F.3d 838 (7th Cir. 1999); *Koveleskie* v. *SBC Capital Mkts., Inc.*, 167 F.3d 361, 367 (7th Cir. 1999), cert. denied, 528 U.S. 811 (1999); *Barker* v. *Golf U.S.A., Inc.*, 154 F.3d 788, 791-792 (8th Cir. 1998), cert. denied, 525 U.S. 1068 (1999); *Torrance* v. *Aames Funding Corp.*, 242 F. Supp. 2d 862 (D. Or. 2002); *Pridgen* v. *Green Tree Fin. Servicing Corp.*, 88 F. Supp. 2d 655, 658 (S.D. Miss. 2000); *Conseco Fin. Servicing Corp.* v. *Wilder*, 47 S.W.3d 335, 342 (Ky. App. 2001); *Rains* v. *Found. Health Sys. Life & Health*, 23 P.3d 1249, 1255 (Colo. App. 2001). But see *Showmethemoney Check Cashers, Inc.* v. *Williams*, 27 S.W.3d 361, 367 (Ark. 2000) (lack of mutuality renders arbitration provision unenforceable); *Armendariz* v. *Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 692-693 (Cal. 2000) (same); *Arnold* v. *United Cos. Lending Corp.*, 511 S.E.2d 854, 862 (W. Va. 1998) (same).

way toward rendering the contract unconscionable.[16] The reality therefore is undeniable: the Alabama Supreme Court simply singled out arbitration clauses for disfavored treatment, in violation of the FAA.

III. THE QUESTIONS PRESENTED HERE ARE RECURRING ONES OF GREAT PRACTICAL IMPORTANCE

The issues presented here plainly warrant the Court's attention. Questions about who is to decide issues of arbitrability arise with great frequency; the Eleventh Circuit began a recent, characteristic opinion by noting that it involved the "familiar scenario": "another arbitration dispute in which the parties are litigating about whether they should be litigating." *Anders*, 346 F.3d at 1026. In this context, as this Court already has recognized, the question of "who – court or arbitrator – has primary authority to decide whether a party has agreed to arbitrate can make a critical difference to a party resisting arbitration." *First Options*, 514 U.S. at 942. It therefore is essential that the rules governing the efficacy of *First Options* clauses be clearly settled.

That is especially so because provisions assigning the arbitrator the authority to determine arbitrability have become commonplace. As this case illustrates, such claims frequently appear in consumer contracts of all kinds. Indeed, as several of the decisions discussed above indicate, the rules of leading arbitral organizations such as the International Chamber of Commerce and the NASD expressly assign the determination

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[16] There is a special oddity in this aspect of the holding below. Congress enacted the FAA specifically to facilitate and encourage the use of arbitration; the Alabama Supreme Court, however, would use the "prevalence" of arbitration clauses – and thus the success of the congressional policy – as a factor that tends to *invalidate* such clauses.

of arbitrability to the arbitrator. See *Shaw*, 322 F.3d at 122-123 (citing rules of the ICC); *Apollo Computer*, 886 F.2d at 473 (same); *Daiei, Inc.* v. *United States Shoe Corp.*, 755 F. Supp. 299, 302-303 (D. Haw. 1991) (same); *FSC Sec.*, 14 F.3d at 1312-1313 (citing rules of the NASD); *Bybyk*, 81 F.3d at 1202 (same). Moreover, courts generally have held that contracts incorporating those rules by reference should be deemed to include *First Options* clauses. There accordingly can be no doubt that questions like the ones presented in this case will recur regularly in the future.

More broadly, clarity in the rules governing *First Options* clauses in particular, and the enforceability of arbitration agreements in general, is imperative because arbitration has become a central mechanism for dispute resolution in the United States – just as Congress intended when it enacted the FAA. Although there are no comprehensive statistics available, it is certain that, at a minimum, many millions of individuals and untold thousands of businesses are signatories to arbitration agreements.[17] Hundreds of thousands of disputes are resolved by arbitration every year.[18] And the numbers are

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[17] As of 2002, some six million employees were covered by American Arbitration Association arbitration plans; as of 1998, 62% of large corporations had used employment arbitration on at least one occasion. Hill, *Due Process and Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO ST. J. ON DISP. RESOL. 777, 770-780 (2003). And arbitration agreements are used in consumer, securities, and business-to-business contracts of all kinds.

[18] The American Arbitration Association alone administered more than 230,000 arbitrations in 2002. See American Arbitration Association, 2002 President's Letter and Financial Statements, at 2. Other arbitral organizations handle many more. See, *e.g.*, Sabin, *The Adjudicatory Boat Without a Keel: Private Arbitration and the Need for Public Oversight of Arbitrators*, 87 IOWA L. REV.

growing exponentially as the lower cost, greater speed, and flexibility of arbitration make it an increasingly attractive alternative to litigation.[19]

As this case also demonstrates, however, the judicial resistance to arbitration that Congress sought to eliminate with passage of the FAA still is expressed in many quarters. Commentators regularly note the "continuation of judicial hostility to the arbitration process as evidenced by courts refusing to compel arbitration of garden variety claims under garden variety agreements to arbitrate, routinely enforced in other cases." Neeseman, *Development of Interest in U.S. Arbitration*, in Securities Arbitration 2003 Simplifying Complexity, at 45 (PLI Corp. Law & Practice Course Handbook Series, No. BO-OING, Aug. 2003).[20]

1337, 1339-1340 (2002) (NASD handled more than 5600 arbitrations in 2001).

[19] See, *e.g.*, Hill, *supra*, 18 OHIO ST. J. ON DISP. RESOL. at 779-780 (number of employees covered by American Arbitration Association employment arbitration plans doubled between 1997 and 2002); Sabin, *supra*, 87 IOWA L. REV. at 1339-1340 (American Arbitration Association's caseload grew from 55,800 in 1995 to 136,673 in 1999 (and to 230,258 in 2002, see note 18, *supra*); NASD caseload grew from 3651 in 1989 to 5661 in 2001).

[20] See, *e.g.*, Kaplinsky & Levin, *The Gold Rush of 2002: California Courts Lure Plaintiffs' Lawyers (But Undermine Federal Arbitration Act) By Refusing to Enforce "No-Class Action" Clauses in Consumer Arbitration Agreements*, 58 BUS. LAW. 1289 (May 2003); Manakides, *Arbitration of "Public Injunctions": Clash Between State Statutory Remedies and the Federal Arbitration Act*, 76 S. CAL. L. REV. 433 (2003); Quick, Keystone, Inc. v. Triad Sys. Corp.: *Is the Montana Supreme Court Undermining the Federal Arbitration Act?*, 63 MONT. L. REV. 445 (2002); Miller & Hart, *The FAA on a Collision Course with the Unconscionability Doctrine*, 21 SUM FRANCHISE L.J. 4 (2001).

Alabama, in particular, is a state that is "historically hostile to arbitration." Brown, *State Court Attempts to Limit the Applicability of the Federal Arbitration Act in a Post*-Lopez *World*, 56 U. MIAMI L. REV. 1051, 1061 (2002). See Richmond, Sisters of the Visitation v. Cochran Plastering Co.: *Earnest Federalism or Reconstructive Defiance to the Federal Arbitration Act?*, 25 AM. J. TRIAL ADVOC. 633, 633, 657 (Spring 2002) ("Perhaps no other state makes arbitration more of a political issue than Alabama," which traditionally "resist[s] the FAA."). Cf. *Citizens Bank* v. *Alafabco, Inc.*, 123 S. Ct. 2037, 2039, 2041 (2003) (reversing Alabama Supreme Court decision holding FAA inapplicable to arbitration agreement there at issue as "misguided" and "improperly cramped"). The decision below is an unfortunate manifestation of that judicial attitude. Because Congress emphatically rejected "'the judiciary's longstanding refusal to enforce agreements to arbitrate'" that is reflected in that decision (*Volt Info. Sci.*, 489 U.S. at 474 (citation omitted)), this Court should grant review to ensure that the Federal Arbitration Act is enforced according to its plain terms.

CONCLUSION

The petition for a writ of certiorari to the Supreme Court of Alabama should be granted.

Respectfully submitted.

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NOVEMBER 2003

APPENDIX

APPENDIX A

MICHAEL J. ANDERSON, et al.

v.

MARY JEAN ASHBY, individually, and as personal representative of the estate of Jimmy Ashby, deceased.

No. 1011740

SUPREME COURT OF ALABAMA

__ So. 2d __, 2003 WL 21125998

May 16, 2003

PER CURIAM.

Michael J. Anderson, American General Finance, Inc., and Merit Life Insurance Company appeal from an order denying their motions to compel arbitration in an action filed against them in the Limestone Circuit Court by Mary Jean Ashby. We affirm.

Background

On April 15, 1999, Mary Jean Ashby and Jimmy Ashby, her now-deceased husband, visited the American General Finance office located in Athens, Alabama,[1] to obtain a $2,000 loan to be secured by their automobile. The loan was to be paid over a period of three years. Mr. Ashby indicated on the loan application that his only source of income was "disability" and "soc. sec."; Mrs. Ashby indicated on the loan application that her only source of income was "disability." According to Mrs. Ashby, Mr. Ashby wanted to obtain credit-life insurance so that she would not have to worry

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[1] The Ashbys lived in Elkmont, Alabama, which is located a few miles outside of Athens, Alabama. Telephone numbers for Athens and Elkmont are published in the same local telephone directory.

about the payments on the loan in the event something happened to him. It is undisputed that Mr. Ashby agreed to pay $827.10 in order to purchase $5,000 of credit-life insurance during the term of their three-year note.

While at American General Finance's office, the Ashbys met with Michael Anderson, the branch manager for American General Finance; Anderson is also an insurance agent for Merit Life Insurance Company, an affiliate of American General Finance. Mr. Anderson acknowledges that, as a result of doing business with the Ashbys, he knew that Mr. Ashby was unable to read and write and that he could not sign his own name. Anderson also admits that he knew Mrs. Ashby was limited in her reading ability.[2]

Mrs. Ashby claims that she and Mr. Ashby asked Anderson to explain the loan documents because they were unable to read and understand the documents. Additionally, the operating procedures of American General Finance applicable to customers who are blind or who cannot read require the company's representative to explain the documents to the customer before obtaining the customer's signature.

Anderson alleges that he explained the loan and credit-life insurance documents to the Ashbys. Anderson claims that, in accordance with American General Finance's operating procedures applicable to illiterate customers, he wrote at the bottom of each document involved in the loan transaction

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[2] Anderson claims that he learned Mr. Ashby could not read only after he had reviewed the federal disclosure statement with the Ashbys, and Mrs. Ashby asked if she could sign for Mr. Ashby. Mr. Ashby testified that they had earlier told Anderson he and Mrs. Ashby could not read and that they had asked him to explain the documents to them. According to the briefs filed with this Court, Mr. Ashby had attended school for only a few weeks and had never been able to read or write. Mrs. Ashby has a fourth-grade education and is able to read small and simple words.

"THIS DOCUMENT EXPLAINED AND UNDERSTOOD BY THE BORROWER." According to Anderson, he then had the Ashbys sign the documents. Mrs. Ashby denies that the documents she executed bore any handwritten statements when she signed them.

The note and security agreement executed by the Ashbys on April 15, 1999, contained an arbitration agreement, which included the following provisions:

> "ARBITRATION OF CLAIMS AND WAIVER OF JURY TRIAL:
>
> "Borrower(s) hereby acknowledge that the transactions evidenced by this agreement involve interstate commerce. Borrower(s) and Lender agree that, except as otherwise set forth in this provision, all claims, disputes, or controversies of every kind and nature between Borrower(s) and Lender shall be resolved by arbitration including (i) those based on contract, tort or statute, (ii) those arising out of or relating to the transaction(s) evidenced by this agreement, the disclosures relating to this agreement, the Federal Disclosure Statement, any insurance certificates or policies, any documents executed at or about the same time this agreement was executed or (iii) those arising out of, [or] relating to any other prior, proposed or actual loan or extension of credit (and the relationships which result from these transactions or any other previous transactions between Borrower(s) and Lender). Borrower(s) and Lender further agree that all issues and disputes as to the arbitrability of claims must also be resolved by the arbitrator.
>
> "BORROWER(S) AND LENDER UNDERSTAND THAT EACH HAS THE RIGHT TO LITIGATE SUCH DISPUTES THROUGH A COURT, AND BORROWER(S) AND LENDER VOLUNTARILY AND KNOWINGLY WAIVE ANY RIGHT THEY HAVE TO

A JURY TRIAL OR JUDGE TRIAL OF SUCH DISPUTES.

" * * *

"BORROWER(S) AND LENDER AGREE THAT THE ARBITRATOR MAY AWARD PUNITIVE DAMAGES ONLY UNDER CIRCUMSTANCES WHERE A COURT OF COMPETENT JURISDICTION COULD AWARD SUCH DAMAGES. HOWEVER, IN NO EVENT SHALL AN AWARD OF DAMAGES EXCEED FIVE (5) TIMES THE ECONOMIC LOSS SUFFERED BY THE PARTY. BORROWER(S) AND LENDER FURTHER AGREE THAT THE ARBITRATOR SHALL NOT CONDUCT ANY CLASS-WIDE PROCEEDINGS AND WILL BE RESTRICTED TO RESOLVING THE INDIVIDUAL DISPUTES BETWEEN THE PARTIES.

"Borrower(s) and Lender agree that, notwithstanding the foregoing, Lender retains the right to use judicial or self-help remedies (i) to repossess or foreclose on collateral or to enforce the security interests relating to this transaction, and (ii) to pursue collection actions against the Borrower(s) where the amount of the debt is $10,000 or less. The exercise of this right by Lender to pursue judicial or self-help remedies shall not constitute a waiver of Lender's right to compel the arbitration of any claim or dispute subject to this arbitration clause – including the filing of a counterclaim by Borrower(s) in a lawsuit filed by Lender.

"This arbitration clause shall be binding upon the assigns, directors, officers, representatives, employees, parent companies, affiliate companies, subsidiaries and successors of lender, and the administrators, assigns, executors, heirs and representatives of Borrower(s). In addition, the parties agree to submit to arbitration not only the forego-

ing claims or disputes against each other, but also all claims or disputes they have against (i) all other persons or entities involved with the transactions subject to this clause, (ii) all persons or entities who signed or executed any of the documentation subject to this clause, and (iii) all persons or entities who may be jointly or severally liable to any of the parties to this agreement regarding matters or events relating to the transactions and documentation subject to this clause.

"Borrower(s) and Lender agree that if any provision of this arbitration clause is invalid or unenforceable under the Federal Arbitration Act, the provision which is found to be invalid or unenforceable shall be inapplicable and deemed omitted, but shall not invalidate the remaining provisions of this arbitration clause, and shall not diminish the parties' obligation to arbitrate the disputes subject to this clause."

(Capitalization in original.) Above the signature line on the note and security agreement is written "THIS DOCUMENT EXPLAINED AND UNDERSTOOD BY THE BORROWER"; on the signature line is an "X," presumably Jimmy Ashby's mark, and Mrs. Ashby's signature.

Included with the application for credit-life insurance submitted to Merit Life Insurance by Jimmy Ashby on April 15, 1999, was a separate, stand-alone document, on which was printed another arbitration agreement.[3] That arbitration agreement provided, in pertinent part:

"ARBITRATION OF CLAIMS AND WAIVER OF JURY TRIAL

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[3] This arbitration agreement does not appear on the application for credit-life insurance; it was printed on a separate, stand-alone document.

"Merit Life Insurance Co. and I hereby acknowledge that the transactions covered by the Policy being applied for involve interstate commerce. We agree that all claims, disputes, or controversies of every kind and nature between us shall be resolved by arbitration including (i) those based on contract, tort, or statute, (ii) those arising out of or relating to the transaction(s) evidenced by a policy, the disclosures relating to a policy, any documents executed at or about the same time a policy was executed or (iii) the relationships which result from these transactions or any other previous transactions between us. Merit Life Insurance Co. and I further agree that all issues and disputes as to the arbitrability of claims must also be resolved by the arbitrator.

"WE UNDERSTAND THAT EACH HAS THE RIGHT TO LITIGATE SUCH DISPUTES THROUGH A COURT, AND WE VOLUNTARILY AND KNOWINGLY WAIVE ANY RIGHT WE HAVE TO A JURY TRIAL OR JUDGE TRIAL OF SUCH DISPUTES.

"* * *

"WE AGREE THAT THE ARBITRATOR MAY AWARD PUNITIVE DAMAGES ONLY UNDER CIRCUMSTANCES WHERE A COURT OF COMPETENT JURISDICTION COULD AWARD SUCH DAMAGES. HOWEVER, IN NO EVENT SHALL AN AWARD OF DAMAGES EXCEED FIVE (5) TIMES THE ECONOMIC LOSS SUFFERED BY THE PARTY. MERIT LIFE INSURANCE CO. AND I FURTHER AGREE THAT THE ARBITRATOR SHALL NOT CONDUCT ANY CLASS-WIDE PROCEEDINGS AND WILL BE RESTRICTED TO RESOLVING THE INDIVIDUAL DISPUTES BETWEEN THE PARTIES.

"This arbitration clause shall be binding upon the assigns, directors, officers, representatives, employees, agents,

> parent companies, affiliated companies, subsidiaries and successors of Merit Life Insurance Co. and my administrators, assigns, executors, heirs and representatives. In addition, the parties agree to submit to arbitration not only the foregoing claims or disputes against each other, but also all claims or disputes they have against (i) all other persons or entities involved with the transactions subject to this clause, (ii) all persons or entities who signed or executed any of the documentation subject to this clause, and (iii) all persons or entities who may be jointly or severally liable to any of the parties to this agreement regarding matters or events relating to the transactions and documentation subject to this clause.
>
> "Merit Life Insurance Co. and I agree that if any provision of this arbitration clause is invalid or unenforceable under the Federal Arbitration Act, the provision which is found to be invalid or unenforceable shall be inapplicable and deemed omitted, but shall not invalidate the remaining provisions of this arbitration clause, and shall not diminish the parties' obligation to arbitrate the disputes subject to this clause."

(Capitalization in original.) Above the signature line on this arbitration agreement was written "THIS DOCUMENT EXPLAINED AND UNDERSTOOD BY APPLICANT"; an "X," presumably Jimmy Ashby's mark, is shown on the signature line.

Although Anderson admits that he never received any training from American General Finance on how to explain an arbitration agreement to customers, he says that he explained the arbitration agreements to the Ashbys. Mrs. Ashby claims that Anderson never explained or mentioned to them the arbitration agreements contained in the loan and credit-life insurance documents. She also claims that she was within hearing distance of Mr. Ashby and Anderson during

the entire closing and that Anderson never explained or mentioned arbitration to Mr. Ashby in connection with the credit-life insurance documents.

On December 2, 1999, Mr. Ashby died. Mrs. Ashby filed a claim for the death benefit provided under the credit-life insurance policy Mr. Ashby had obtained from Merit Life. Merit Life did not pay the claim; instead, it rescinded the policy issued to Mr. Ashby. Merit Life alleged that Mr. Ashby had answered the questions on the insurance application regarding his health inaccurately. Mrs. Ashby alleges that Anderson, who read the questions to them, never asked them any questions about Mr. Ashby's health.

On April 17, 2000, Mary Jean Ashby filed this action in the Limestone Circuit Court, as the personal representative of the estate of her deceased husband Jimmy Ashby, and in her individual capacity. Mrs. Ashby seeks compensatory and punitive damages as a result of Merit Life's refusal to pay benefits under the credit-life insurance policy issued in connection with the American General Finance loan.[4]

Anderson, American General Finance, and Merit Life each moved to stay the proceedings and to compel arbitration, relying upon the arbitration agreements contained in the note and security agreement and executed as part of the application for credit-life insurance. The Ashbys opposed those motions to compel, asserting that the arbitration agreements were unconscionable and that they were obtained through fraud.

On January 22, 2002, after receiving briefs and conducting hearings, the trial court denied the motions to compel arbitration on the grounds that the arbitration agreement

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[4] Mrs. Ashby's complaint alleges fraud, fraudulent suppression, promissory fraud, conspiracy, breach of contract, negligence, and bad-faith refusal to pay an insurance claim.

contained in the note and security agreement was unconscionable and that "fraud in the factum" had occurred with regard to the arbitration agreement executed in connection with the application for credit-life insurance. On February 20, 2002, Anderson, American General Finance, and Merit Life moved, pursuant to Rule 59(e), Ala. R. Civ. P., to alter, amend, or vacate the trial court's order. On May 8, 2002, the trial court denied the defendants' Rule 59(e) motion.

American General Finance, Anderson, and Merit Life appeal, asserting the following claims: that the trial court erred and usurped the arbitrator's authority by deciding the threshold issues of arbitrability; that the trial court erred in concluding that the arbitration agreement included in the note and security agreement was unconscionable; and that the trial court erred in concluding that Mr. Ashby's fraud claim presented a question for the jury.

Standard Of Review

In American General Finance, Inc. v. Morton, 812 So. 2d 282 (Ala. 2001), this Court recited the now familiar standard of review applicable to motions to compel arbitration:

> "This Court reviews the [grant or] denial of a motion to compel arbitration de novo *Green Tree Fin. Corp. v. Vintson*, 753 So. 2d 497, 502 (Ala. 1999); *Patrick Home Ctr., Inc. v. Karr*, 730 So. 2d 1171, 1172 (Ala. 1999). The party seeking to compel arbitration has the initial burden of proving the existence of a contract calling for arbitration and proving that the contract evidences a transaction substantially affecting interstate commerce. *TranSouth Fin. Corp. v. Bell*, 739 So. 2d 1110, 1114 (Ala. 1999); *Sisters of the Visitation v. Cochran*, 775 So. 2d 759 (Ala. 2000). '[A]fter a motion to compel arbitration has been made and supported, the burden is on the nonmovant to present evidence that the supposed arbitration agreement is not valid or does not apply to the dis-

> pute in question.' *Jim Burke Auto., Inc. v. Beavers*, 674 So. 2d 1260, 1265 n.1 (Ala. 1995)."

812 So. 2d at 284-85. Mrs. Ashby does not dispute the existence of a written contract evidencing a transaction substantially affecting interstate commerce; we need not consider those issues in this appeal.

Analysis

I. Did the trial court err and usurp the arbitrator's authority in deciding the threshold issue of arbitrability?

The trial court determined that the arbitration agreement included in the note and security agreement was unconscionable and therefore unenforceable. American General Finance and Anderson appeal, arguing that whether the arbitration agreement was unenforceable was an issue for the arbitrator to decide rather than for the trial court. We disagree.

The Federal Arbitration Act, 9 U.S.C. § 1 et seq. (the "FAA"), "binds us to faithfully apply general principles of Alabama contract law when considering a challenge to the validity of an arbitration agreement." *Green Tree Fin. Corp. v. Wampler*, 749 So. 2d 409, 416 (Ala. 1999). As Justice Lyons noted in his concurring opinion in *Ex parte Dan Tucker Auto Sales, Inc.*, 718 So. 2d 33 (Ala. 1998):

> "Alabama has long recognized the doctrine of unconscionability as a defense to enforcement of a contract. While *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), relegates challenges to the validity of a contract as a whole to the arbitrator, a challenge to the arbitration clause only is properly determined by the court."

718 So. 2d at 43 (Lyons, J., concurring specially) (citation omitted). This Court reached the same conclusion in *American General Finance, Inc. v. Branch*, 793 So. 2d 738 (Ala. 2000), a case almost identical to this one. In *Branch*, this

Court rejected an argument identical to the one raised by American General Finance and Anderson in this case: that because the parties had agreed that issues of arbitrability were to be decided by the arbitrator, the trial court had no authority to address the issue of unconscionability. The *Branch* Court stated:

> "'[A] determination that, by the terms of the arbitration clause, the arbitrator is to decide issues of arbitrability, does not end the inquiry.' 'Where the attack is addressed to the arbitration clause itself, as opposed to the contract as a whole, the court, and not the arbitrator, resolves the issue.' Thus, the threshold 'issue of unconscionability of an *arbitration clause* is a question for the court and not the arbitrator.'"

793 So. 2d at 748 (quoting *Green Tree Fin. Corp. v. Wampler*, 749 So. 2d 409, 413, 415 (Ala. 1999), and citing *Ex parte Napier*, 723 So. 2d 49 (Ala. 1998)); *Ex parte Dan Tucker Auto Sales, Inc.*, 718 So. 2d at 41 (Lyons, J., concurring specially).

We agree with *Branch* and the cases cited in that opinion. Because Mrs. Ashby contends that the arbitration agreement included in the note and security agreement was itself unconscionable, the trial court did not err in holding that it had the authority to resolve that issue.

II. Did the trial court err in ruling that the arbitration agreement included in the note and security agreement was unconscionable as a matter of law?

American General Finance and Anderson argue that the trial court erred in concluding that the arbitration agreement included in the note and security agreement was unconscionable as a matter of law. In reaching that conclusion, the trial court relied heavily upon *Branch,* which it summarized in its order. In pertinent part, the trial court's order provided:

"The defense of unconscionability must be addressed by the trial court. *Green Tree Financial Corp. v. Vintson*, 753 So. 2d 497 (Ala. 1999). The party asserting the affirmative defense of unconscionability has the burden of proof. *Green Tree Fin. Corp. v. Wampler*, 749 So. 2d 409 (Ala. 1999). The doctrine of unconscionability is codified at [Ala.Code 1975, § 5-19-16], which provides:

> "'With respect to a consumer credit transaction, if the court as a matter of law finds the contract or any provision of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable provision, or it may so limit the application of any unconscionable provision so as to avoid any unconscionable result.'

"The Alabama Supreme Court set forth a two-part test to be applied by this court in determining unconscionability: (1) Terms that are grossly favorable to a party that has (2) overwhelming bargaining power. *American General Finance, Inc. v. Branch*, 793 So. 2d 738, 748 (Ala. 2000). The court notes that the arbitration clause in the note and security agreement supplied by [American General Finance] in this case is identical to that supplied by [American General Finance] in *Branch*. The Alabama Supreme Court affirmed the trial court's denial of [American General Finance's] Motion to Compel Arbitration in *Branch* because it found the arbitration clause unconscionable.

"The same grossly favorable terms favoring [American General Finance] that existed in *Branch* are present here. The first indicium of unconscionability is the breadth of the clause. The *Branch* court stated that the clause applied 'to every cause of action that could conceivably arise in favor of Branch, and to every individual against whom a claim could conceivably be brought.' *Id.*

"A second indicium of unconscionability is the provision purporting to invest the arbitrator with the threshold issues of arbitrability. The *Branch* court stated that '"[s]uch authority of the arbitrator to determine its own authority may itself be an indicium of unconscionability."' *Id.* at 749, quoting *Brilliant Homes, Ltd. v. Lind*, 722 So. 2d 753, 755 (Ala. 1998).

"A third indicium of unconscionability is the provision exempting the defendants from the duty to arbitrate and expressly reserving the right to try to a jury their claims against the Ashbys up to $10,000. In *Branch*, the Alabama Supreme Court stated:

> '"Practically speaking, this provision *benefits only the [l]enders*. In other words, American General [Finance] reserved for itself the right to collect by *judicial action* the loan payments – the only species of claim it would ever realistically be expected to assert against Branch – while requiring Branch to settle by *arbitration* claims such as breach of contract and fraud – the species of claims she would most likely assert against the [l]enders.' (emphasis in original).

[793 So. 2d at 749.]

"The [American General Finance] arbitration provision limits the right of the arbitrator to award an amount in excess of five times the amount of economic loss. The *Branch* court stated 'this limitation includes not only punitive damages, but all species of noneconomic loss, such as mental anguish.' [793 So. 2d at 749.] The *Branch* court found it significant that the arbitration clause prevented the borrower from obtaining the full range of relief available under Alabama law, but allowed the lenders to seek full redress for their claims in court. *Id.*

"The *Branch* court found that the [American General Finance] arbitration provisions were so grossly favorable to

the defendants as to pass the first prong of the unconscionability test. *Id.* at 750.

"Along with each grossly favorable term constituting an indicium of unconscionability found in the *Branch* case, this court finds an additional indicium of unconscionability. The Ashbys requested that the defendants explain the terms of the contract to them. The defendant's agent chose not to explain, or even mention, the arbitration clause. Such a refusal of assistance is an indicium of unconscionability. *Ex parte Napier*, 723 So. 2d 49, 52 (Ala. 1998).

"The second prong of the unconscionability test set forth in *Branch* is overwhelming bargaining power. *American General Finance, Inc. v. Branch*, 793 So. 2d 738, 748 (Ala. 2000). The *Branch* court stated that '[a] primary indicium of unconscionability in the modern consumer-transaction context is whether the consumer has the ability "to obtain the product made the basis of [the] action" without signing an arbitration clause.' *Id.* at 750, quoting *Green Tree Fin. Corp. v. Wampler*, 749 So. 2d 409, 415 (Ala. 1999).

"In *Branch,* the record contained stipulations and affidavit testimony of eight of the sixteen companies (the eight including [American General Finance]) that were listed in the advertising pages of the Southern Directory Company telephone directory for the City of Tuscaloosa under the heading of 'financing.' Of those eight companies only one did not routinely enter into arbitration agreements in connection with its loans during the applicable time period. [793 So. 2d] at 751. The *Branch* court noted that '"[e]ntire segments of the market for certain goods and services * * * are being closed to consumers who are unwilling to forfeit their rights guaranteed them by the federal and state Constitutions."' *Id.*, quoting *Allstar Homes,*

Inc. v. Waters, 711 So. 2d 924, 933 (Ala. 1997). The *Branch* court held that [American General Finance] possessed overwhelming bargaining power because 'Branch would have had to expend considerable time and effort even to *find* [companies that would not require arbitration].' [793 So. 2d] at 751 (emphasis in original).

"In the case at hand, the record reveals that ten companies advertised under the heading 'financing' in the Athens BellSouth Yellow Pages at the time that the Ashbys applied for their loan. The parties presented evidence from nine of those ten companies. Of those nine companies, three (Badcock Home Furnishing Center, First South Production Credit Association and First Trust Mortgage of Athens) did not routinely make loans to consumers using personal property as collateral – the type of loan at issue. *All* of the six remaining companies, including [American General Finance], required arbitration agreements of their customers. The record further reveals that the defendants presented affidavits from four banks and financial institutions that did not require arbitration agreements that maintained an office in Athens, Alabama, but [that] were not listed under 'financing' in the Yellow Pages. The evidence also reveals that the Ashbys presented evidence of four such additional institutions that did require arbitration agreements. The defendants presented affidavits from companies that did not require arbitration agreements in cities other than Athens.

"In order to meet their burden of proof on this issue, the Ashbys 'need not show that the market was *completely* closed, only that [they were] unable to acquire goods or services without *considerable* expenditure of time and resources.' [793 So. 2d] at 751 (emphasis in original). The court concludes that the Ashbys have met this burden. The evidence reveals that the Ashbys had no input into the drafting of the note and security agreement provided

> by [American General Finance]. The court concludes that the evidence demonstrates that the Ashbys had no meaningful choice and that [American General Finance] had overwhelming bargaining power. As a result of the two-part analysis as set forth in *Branch*, this court holds that the arbitration provisions in the American General Finance contract [are] unconscionable and unenforceable."

The First Prong of Branch – *Grossly Favorable Terms*

As the trial court noted, the arbitration agreement included in the note and security agreement is identical to the arbitration agreement this Court found unconscionable in *Branch*. Thus, each of the provisions of the *Branch* arbitration agreement found to be grossly favorable to the lenders is also present in the Ashbys' arbitration agreement with American General Finance. Those provisions grossly favorable to American General Finance are: (1) the breadth of the arbitration agreement, which extends to every cause of action that might conceivably arise in favor of the Ashbys and that applies to every individual or entity against whom the Ashbys might bring a claim; (2) the provision purporting to invest the arbitrator with the threshold issue of arbitrability; (3) the provision reserving to American General Finance the right to a trial by jury while mandating that the Ashbys arbitrate any and every claim that might arise; and (4) the provision limiting the Ashbys' right of recovery for all species of damages to no more than five times the economic loss while preserving American General Finance's right to seek full redress for its claims.

We agree with the trial court that the arbitration agreement contained in the note and security agreement is grossly favorable to American General Finance. Accordingly, Mrs.

Ashby has met the first prong of the *Branch* unconscionability test.

The Second Prong of Branch – *Overwhelming Bargaining Power*

American General Finance and Anderson argue that the trial court erred in finding the arbitration agreement unconscionable because, they argue, Mrs. Ashby failed to meet the second prong of the *Branch* unconscionability test. American General Finance and Anderson argue that the trial court ignored evidence presented indicating that there were lenders in the financial market available to the Ashbys that would make loans without requiring an arbitration agreement and that ignoring that evidence caused the trial court to err in concluding that the Ashbys had no meaningful choice and could not obtain an arbitration-free loan. Further, American General Finance and Anderson argue that Mrs. Ashby cannot meet the second prong of the *Branch* test because, they say, she failed to present any evidence indicating that she and Mr. Ashby actually shopped around for an arbitration-free loan. We reject these arguments.

First, we note that the trial court limited the financial market it considered to be available to the Ashbys to those lenders advertising in the yellow pages of the Athens BellSouth telephone directory under "financing" at the time the Ashbys applied with American General Finance for their loan in April 1999.[5] This is exactly the type of comparison this Court made in *Branch,* and we find no error in this method of determining the applicable market available to the Ashbys. See *Branch*, 793 So. 2d at 751 (considering the appropriate

[5] See the Appendix to this opinion for a summary of the evidence before the trial court regarding financial companies, banks, and credit unions in the Athens, Decatur, and Huntsville areas at that time.

comparable financial market to be composed of those entities listed in the advertising pages of the Southern Directory Company telephone directory for the city nearest the plaintiff).

Moreover, the trial court did not err in concluding that the arbitration agreement in the note and security agreement was unconscionable in the absence of evidence indicating that the Ashbys sought other alternatives to the American General Finance loan. Our decision in *Branch* regarding meaningful choice was based upon affidavits and stipulations regarding the practices of nearby lenders that were in the business of making loans comparable to the one Branch sought to obtain. In *Branch,* we stated:

> "From the sample responses of the companies providing the kind of financing for which Branch was shopping in her geographical area, it follows that only 1 or 2 companies out of 16 might have allowed her to borrow money in November 1997 without agreeing to arbitrate. Branch *would have had* to expend considerable time and effort even to *find* these companies."

793 So. 2d at 751 (first emphasis added; second emphasis in original). Thus, our holding in *Branch* was not based upon evidence showing that Branch had actually gone out and traveled a particular geographical area of the state in an unsuccessful attempt to obtain a loan free from the restriction of an arbitration clause. We concluded that American General Finance possessed overwhelming bargaining power because "Branch *would have had* to expend considerable effort even to *find*" the 1 or 2 of the 16 companies that would not have required arbitration. 793 So. 2d at 751.

In this case, Mrs. Ashby presented the same type of evidence we considered in *Branch.* Mrs. Ashby presented the trial court with evidence indicating that, at the time she and Mr. Ashby obtained their loan with American General Fi-

nance in 1999, 10 companies, including American General Finance, advertised in the yellow pages of the Athens Bell-South telephone directory under the category "financing." Mrs. Ashby presented evidence indicating that 2 of those 10 companies did not make loans of the type sought by the Ashbys,[6] while 6 companies, including American General Finance, did make loans comparable to the one sought by the Ashbys.[7] Mrs. Ashby presented evidence indicating that all six of those companies required their customers to sign arbitration agreements. Thus, we conclude, as we did in *Branch*, that the Ashbys would have had to expend considerable time and effort to locate the remaining two companies, and it is unknown whether those companies would have insisted that the Ashbys sign an arbitration agreement.

Justice Stuart, in her special writing, states that she would require evidence showing that the plaintiff actually shopped around for an arbitration-free loan. She relies upon the recent cases of *Mason v. Acceptance Loan Co.*, [Ms. 1010563, Sept. 27, 2002] __ So. 2d __ (Ala. 2002); *Vann v. First Community Credit Corp.*, 834 So. 2d 751 (Ala. 2002), and *Green Tree Fin. Corp. v. Lewis*, 813 So. 2d 820 (Ala. 2001). Her writing prompts additional observations.

Anderson, the corporate defendants' agent and himself a defendant, admits that he knew that the Ashbys could not

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[6] Another of the 10 companies that advertised was a mortgage company – First Trust Mortgage Company. Although the trial court's order indicated that this company did not make loans comparable to the one obtained by the Ashbys, we are unable to locate any evidence in the record regarding the lending practices of this company.

[7] We are unable to locate in the record any evidence regarding the lending practices of Compass Bank, which was another of the 10 lenders advertising under the category "financing" in 1999 in the Athens telephone directory.

read the documents he presented to them. The "operating procedures" of American General Finance itself therefore required Anderson to explain those documents to the Ashbys, and Anderson did in fact undertake and purport to explain the documents to the Ashbys. These facts are undisputed. Mrs. Ashby, further, has submitted evidence indicating that she and Mr. Ashby requested an explanation of the documents and that Anderson withheld from the explanation he gave any mention of the presence or the effect of any "arbitration agreement."

Mason, on which Justice Stuart relies in her special writing, cites *Mitchell Nissan, Inc. v. Foster*, 775 So. 2d 138, 140 (Ala. 2000), for the proposition that "an illiterate person, 'if he neglects to have [a document he signs] read, or to [i]nquire as to its contents,' cannot, 'in the absence of fraud, deceit, or misrepresentation, avoid the effect of his signature because [he is] not informed of its contents.'" (Quoting *Beck & Pauli Lithographing Co. v. Houppert & Worcester*, 104 Ala. 503, 506, 16 So. 522, 522 (1894).) Mrs. Ashby's evidence fulfills both exceptions to the binding effect of their signatures. First, they *did* "[i]nquire as to * * * [the] contents" of the documents. *Id.* Second, Anderson *did* commit "fraud, deceit, or misrepresentation," *Foster*, 775 So. 2d at 140, if Mrs. Ashby's allegation that in explaining the documents he failed to mention the arbitration agreement be true.

Neither *Vann* nor *Lewis* constitutes a retreat from *Branch*. Each turns on the utter failure of the plaintiffs to submit evidence of the scarcity of lenders that did not require arbitration agreements in the particular market in which the plaintiffs were seeking loans. *Vann*, 834 So. 2d at 754, and *Lewis*, 813 So. 2d at 825. Mrs. Ashby, like the plaintiff in *Branch*, did submit such evidence.

Finally, the facts of this case do not logically present an issue whether the Ashbys should have "actually shopped

around" for a lender that would not require that they execute an arbitration agreement. The Ashbys' inability to read the documents and agent Anderson's alleged failure to mention the "arbitration agreement" when he undertook and purported to explain the documents to them deprived the Ashbys of any reason to "shop around" for such a lender.

The trial court also determined, and we agree, that the Ashbys had no input into negotiating the terms of or drafting the arbitration agreement. This evidence establishes that the Ashbys had no meaningful choice in accepting the arbitration agreement and that American General Finance had overwhelming bargaining power in obtaining the arbitration agreement.[8] For these reasons, we find that the evidence is sufficient to meet the second prong of the *Branch* unconscionability test.

Severability Provision

American General Finance and Anderson next argue that, even assuming that the trial court properly concluded that the arbitration agreement included in the note and security agreement contains some unconscionable provisions, the trial court erred by not striking only those provisions it found to

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[8] American General Finance and Anderson argue that Mrs. Ashby's testimony that she and her husband had obtained a loan within the last 10 years from Regions Bank indicates that the Ashbys could have shopped at local banks for this loan. Because some local banks did not require consumers to sign arbitration agreements in 1999, American General Finance and Anderson argue that the Ashbys had a meaningful choice whether to obtain a loan without an arbitration agreement. However, Mrs. Ashby testified that she and her husband had obtained a loan from Regions Bank at some time in the past but that she had no idea how long ago. She also testified that she and Mr. Ashby did not want to return to Regions Bank for this loan because, given Mr. Ashby's age, Regions Bank would not provide him with credit-life insurance.

be unconscionable while enforcing the remainder of the arbitration agreement, pursuant to the severability clause included in that arbitration agreement. American General Finance and Anderson rely upon *Cavalier Mfg., Inc. v. Jackson*, 823 So. 2d 1237 (Ala. 2001), overruled on other grounds, *Ex parte Thicklin*, 824 So. 2d 723 (Ala. 2002); and on *Ex parte Thicklin*, *supra*, as authority for their argument.

In *Cavalier Manufacturing* and *Ex parte Thicklin* this Court struck only the offensive provisions of the arbitration agreements under consideration in those cases and upheld the remainder of those agreements. However, the arbitration agreements considered in those cases contained only one unconscionable provision; the arbitration agreement in this case is unconscionable in numerous aspects. For this reason alone, *Cavalier Manufacturing* and *Ex parte Thicklin* are distinguishable.

Additionally, in *Ex parte Thicklin*, this Court expressly recognized:

> "This Court has limited authority to deal with the enforceability of contract terms. It can nullify or reform a contract on the basis of fraud; it can also nullify or reform a contract to eliminate any unconscionable provisions or terms that violate public policy."

824 So. 2d at 732 (citing in a footnote *Ex parte State Farm Fire & Cas. Co.*, 764 So. 2d 543, 546 (Ala. 2000) (Lyons, J., concurring specially)). See also § 5-19-16, Ala. Code 1975, which states, in pertinent part:

> "With respect to a consumer credit transaction, if the court as a matter of law finds the contract or any provision of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable provision, or it may so limit

the application of any unconscionable provision so as to avoid any unconscionable result."

We conclude that the arbitration agreement included in American General Finance's note and security agreement meets the two-part test for unconscionability set forth in *Branch*. The entire arbitration agreement is unconscionable and therefore unenforceable. We affirm the trial court's order denying the motion to compel the Ashbys' claims against American General Finance and Anderson to arbitrate under that agreement.

III. Did the trial court err in concluding that Mr. Ashby's fraud claim presented a question for the jury?

Mrs. Ashby alleges that the arbitration agreement executed in connection with the Merit Life application for credit-life insurance was obtained by fraud.[9] The trial court concluded that Mrs. Ashby presented substantial evidence of fraud in the factum and, therefore, that her claims must be resolved by a jury. Merit Life appeals. We affirm.

Whether we view Mrs. Ashby's fraud claim as one of fraudulent inducement or as one of fraud in the factum, we conclude that the claim presents a jury question.

If we construe the claim as alleging that Mr. Ashby was fraudulently induced into signing the arbitration agreement presented in conjunction with Merit Life's credit-life insurance application, that claim is not subject to arbitration be-

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[9] Mrs. Ashby alleges that both arbitration agreements were obtained by fraud. Because the trial court concluded that the arbitration agreement included in the note and security agreement was unconscionable and unenforceable, the trial court addressed the issue of fraud only with respect to the arbitration agreement executed in connection with the Merit Life credit-life insurance application.

cause it is directed at the arbitration agreement itself.[10] In *Investment Management & Research, Inc. v. Hamilton*, 727 So. 2d 71 (Ala. 1999), this Court stated:

> "[W]hen a claim of fraud in the inducement is directed toward the arbitration clause itself, the issue is adjudicated by the court. On the other hand, when a claim of fraud in the inducement is directed toward the entire contract * * * the issue is subject to arbitration."

727 So. 2d at 78 (relying on *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967)).

Conversely, if we construe the claim as alleging that Mr. Ashby was deceived as to the character or basic nature of the document (i.e., the arbitration agreement) he signed, the claim is one of fraud in the factum. Claims of fraud in the factum are likewise not subject to arbitration. As this Court recognized in *Harold Allen's Mobile Home Factory Outlet, Inc. v. Early*, 776 So. 2d 777 (Ala. 2000):

> "We do not interpret the Earlys' allegations as falling within the class of fraud termed fraud in the factum, or execution, as distinguished from fraud in the inducement, or treaty, and, thus, as permitting the Earlys to avoid the obligation to arbitrate. See *Drinkard v. Embalmers Supply Co.*, 244 Ala. 619, 14 So. 2d 585 (1943) (explaining distinction between fraud in the factum and fraud in the inducement). As Professor Farnsworth explains in his treatise, fraud in the factum applies only '[i]n rare cases [where] the misrepresentation is regarded as going to the very character of the proposed contract itself * * *.' E. Allen Farnsworth, *Contracts*, § 4.10 (1982); see also *Restatement (Second) of Contracts* § 163 & cmt. a (1981)

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[10] As discussed below, in the absence of other special circumstances, the allegations do not necessarily state a claim that one was fraudulently induced into executing an arbitration agreement.

('If a misrepresentation as to the character or essential terms of a proposed contract induces conduct that appears to be a manifestation of assent by one who neither knows nor has reasonable opportunity to know of the character or essential terms of the proposed contract, his conduct is not effective as a manifestation of assent.'). These rare cases '"include situations involving blind persons, illiterate persons, [and] foreign speaking persons."' *Alfa Mutual Ins. Co. v. Northington*, 561 So. 2d 1041, 1049 (on application for rehearing) (Houston, J., concurring specially) (citations omitted); see, e.g., *Cancanon v. Smith Barney, Harris, Upham & Co.*, 805 F.2d 998 (11th Cir. 1986) (case involving persons who '[had] no knowledge of the English language' 805 F.2d at 999). Alabama law has a long line of cases recognizing the following rule regarding fraud in the factum:

> " ' " 'When the execution of an instrument, which the party signing did not intend to sign, and did not know he was signing, is procured by a misrepresentation of its contents, and the party signing it does so without reading it or having it read, relying upon such misrepresentations and fraud, and believing he is signing a different instrument, he can avoid the effect of his signature notwithstanding he was able to read and had an opportunity to read the instrument.' " '

"*Willcutt v. Union Oil Co. of California*, 432 So. 2d 1217, 1220 (Ala. 1983) (quoting earlier cases and collecting cases). See also *W.T. Rawleigh Medical Co. v. Wilson*, 7 Ala. App. 242, 252, 60 So. 1001, 1005 (1912), and cases cited therein. Alabama caselaw, like the *Restatement*, recognizes that to constitute fraud in the factum, and thereby to prevent the formation of a contract, the misrepresentation must go to the essential nature or existence of the contract itself, for example, a misrepresentation that an instrument is a promissory note when in fact it is a

mortgage, see *Edwards v. Tabb*, 242 Ala. 209, 210, 5 So. 2d 770, 771 (1942). A misrepresentation that concerns a misapprehension of the legal meaning of a term or provision in a contract does not constitute fraud in the factum. See *Rutter & Hendrix v. Hanover Fire Ins. Co.*, 138 Ala. 202, 215, 35 So. 33, 37 (1903) ("'[A]ll our decisions hold, that in the absence of a relation of trust and confidence, or of some other peculiar fact or circumstance, a misrepresentation of [a] matter of law, or of [a] matter of judgment equally open to the observation or inquiries of both parties, or of mere opinion, will not vitiate a contract.' * * * '[A] misrepresentation of the legal effect of a written instrument was, from its very nature, but the expression of an opinion upon a question of law, equally open to the observation and inquiries of both parties, and as to which, the law presumes that the party to whom it was made had knowledge.'") (citations omitted); see also *Restatement (Second) of Contract* § 164 & cmt. b, illus. 2 & 3 (1981).

"The Earlys do not allege that they did not know they were signing an arbitration agreement (indeed, their question to Harold Allen's salesman makes it clear they were aware of the arbitration agreement) or that the salesman represented that the document they were signing was not an arbitration agreement or that it had no legal effect. Instead, they allege that Harold Allen's salesman misrepresented the legal meaning of the arbitration agreement and that they relied on that misrepresentation. However, under the rule of *Rutter & Hendrix*, absent a confidential relationship or other special circumstances between the Earlys and Harold Allen, the salesman's misrepresentation of the legal meaning of the arbitration agreement cannot form the basis for a claim of fraud in the factum. Accordingly, we would interpret the Earlys' allegations as going to inducement."

776 So. 2d at 783 n.6.

Although Mrs. Ashby's allegations could fit under either type of case, her allegations appear to be virtually identical to those presented in *Oakwood Mobile Homes, Inc. v. Barger*, 773 So. 2d 454 (Ala. 2000), which this Court characterized as involving fraud in the factum. In that case, this Court stated:

> "Fraud in the inducement consists of one party's misrepresenting a material fact *concerning the subject matter of the underlying transaction* and the other party's relying on the misrepresentation to his, her, or its detriment in executing a document or taking a course of action. *See Reynolds v. Mitchell*, 529 So. 2d 227 (Ala. 1988).
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> "Larry Barger's assertion – that he signed the arbitration agreement in reliance upon Clary's [Oakwood's manager's] statement that Larry was signing papers for insurance purposes so that the mobile home could be moved – is better characterized as a claim of fraud in the factum. Fraud in the factum occurs when a party 'procures a[nother] party's signature to an instrument without knowledge of its true nature or contents.' *Langley v. Federal Deposit Ins. Corp.*, 484 U.S. 86, 93 (1987). *See also Drinkard v. Embalmers Supply Co.*, 244 Ala. 619, 14 So. 2d 585 (1943), and *Burroughs v. Pacific Guano Co.*, 81 Ala. 255, 1 So. 212 (1887). Fraud in the factum constitutes ineffective assent to the contract. *Cancanon v. Smith Barney, Harris, Upham & Co.*, 805 F.2d 998 (11th Cir. 1986).
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> "* * * *
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> "In *Shearson Lehman Bros.[, Inc. v. Crisp*, 646 So. 2d 613 (Ala. 1994)], this Court recognized that a challenge to avoid or to rescind a contract is subject to arbitration but a challenge to the very existence of a contract is not subject to arbitration. A claim of fraud in the factum is a challenge to the very existence of the contract * * *.

> [B]ecause this Court has adopted the rationale of *Three Valleys [Municipal Water District v. E.F. Hutton & Co.*, 925 F.2d 1136 (9th Cir. 1991)], a claim of fraud in the factum is to be decided by a trial court or a jury.
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> "The Bargers claim that Clary represented the documents as being 'for insurance purposes,' when, in fact, one of the documents was an arbitration agreement, which Larry never knowingly signed as an arbitration agreement. Therefore, we treat the Bargers' claim of fraud in the inducement as a claim of fraud in the factum. The critical issue is whether the Bargers presented substantial evidence to support a claim of fraud in the factum.
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> "Fraud in the factum is a traditional fraud. A claim of fraud, including such fraud as fraud in the factum, requires the party making the claim to prove by substantial evidence that he or she *reasonably relied* on the alleged misrepresentation."

773 So. 2d at 459-61. In addressing the merits of Barger's fraud claim, the *Barger* Court pointed out that the arbitration agreement signed by Larry was clearly marked "ARBITRATION AGREEMENT"; that Larry did not state in his affidavit that he could not read; and that Larry did not state that Clary had prevented him from reading the documents he signed. 773 So. 2d at 461. Because of those factors, the *Barger* Court concluded that Larry would have had to close his eyes to the truth to believe that the documents he signed did not include an arbitration agreement and that, therefore, Larry could not establish the necessary element of reasonable reliance to support his fraud claim. For that reason, the *Barger* Court held that Barger's fraud claim lacked merit and that the trial court had erred in denying Oakwood's motion to compel Barger's claims to arbitration.

Implicit in the Court's holding in *Barger* was the recognition that Oakwood's agent – Clary – had no duty to expressly

disclose the existence of the arbitration agreement to Barger because Barger was capable of reading the documents himself. This is consistent with Alabama contract law. See, e.g., *Rutter & Hendrix v. Hanover Fire Ins. Co.*, 138 Ala. 202, 215, 35 So. 33, 37 (1903), quoted in *Harold Allen's Mobile Home Factory Outlet*, 776 So. 2d at 783 n.6.

This case shares some similarities with *Barger*. Mrs. Ashby, as Mr. Ashby's personal representative, acknowledges that Mr. Ashby intended to sign the credit-life insurance application and that Anderson told him he was signing an application for credit-life insurance. As did the plaintiff in *Barger*, Mrs. Ashby alleges that Mr. Ashby was not told that one of the documents he was signing was an arbitration agreement; Mrs. Ashby alleges that Mr. Ashby had no knowledge that he was entering into such an agreement. Here the similarities to *Barger* end.

Unlike the plaintiff in *Barger*, Mr. Ashby could not read. Anderson knew that Mr. Ashby could not read, and, under the facts of this case, Mr. Ashby had no way to determine for himself that he was signing, in addition to an application for credit-life insurance, an agreement to arbitrate any claim he might have against Merit Life. We cannot say, as we could and did in *Barger*, that Mr. Ashby must have closed his eyes to the truth to believe the document he signed was not an arbitration agreement. We conclude that whether Mr. Ashby's reliance upon Anderson's representations was reasonable must be determined by the finder of fact.

Moreover, we are presented with allegations that, if meritorious, give rise to the special circumstances absent in *Barger*: the Ashbys were unable to read the documents for themselves; Anderson was aware of the fact that the Ashbys could not read the documents; Mrs. Ashby alleges that she and Mr. Ashby asked Anderson to explain the documents to them but, she alleges, he failed to do so; and American Gen-

eral Finance's own internal operating procedures *required* Anderson to explain the documents to any customers who indicated that they were unable to read. The parties dispute whether such an explanation was given. Further, Anderson wrote at the bottom of the arbitration agreement: "THIS DOCUMENT EXPLAINED AND UNDERSTOOD BY APPLICANT." However, Mrs. Ashby alleges that this statement is false because, she says, the arbitration agreement was never explained or mentioned to them. Again, a factual dispute exists.

These circumstances present a question of fact as to whether, under the circumstances of this case, Anderson had a duty to disclose the existence of the arbitration agreement to Mr. Ashby and, if so, whether he did in fact make such a disclosure. Because these issues address the validity of the Ashbys' agreement to arbitrate, they are to be resolved by the fact-finder.

Conclusion

We conclude that the arbitration agreement included in American General Finance's note and security agreement is unconscionable and therefore unenforceable. We also conclude that the question whether the arbitration agreement contained in the Merit Life application for credit-life insurance was obtained by fraud is a question for the jury. We affirm the trial court's denial of the motions to compel arbitration filed by American General Finance, Anderson, and Merit Life.

AFFIRMED.

HOUSTON, LYONS, JOHNSTONE, HARWOOD, and WOODALL, JJ., concur.

MOORE, C.J., concurs in the result.

BROWN and STUART, JJ., concur in part and dissent in part.

SEE, J., concurs in the result in part and dissents in part.

Appendix to Per Curiam Opinion

The following evidence regarding financial companies, banks, and credit unions doing business in the Athens, Decatur, and Huntsville areas at the time the Ashbys applied for their loan was before the trial court. The first 10 of the following lenders advertised in the yellow pages of the BellSouth telephone directory under the category "financing" for the cities of Athens and Elkmont at the time the Ashbys obtained their loan from American General Finance:

1. American General Finance – Athens; made similar consumer loans; required arbitration agreement;

2. Colonial Bank – Athens location; made similar consumer loans; routinely required arbitration agreement;

3. First Family Financial Services – Athens; made similar consumer loans; required arbitration agreement;

4. 1st Community Credit Corporation – Athens; made similar consumer loans; required arbitration agreement;

5. Washington Mutual Finance Company (formerly Blazer Financial Services); made similar consumer loans; required arbitration agreement;

6. Wells Fargo Financial Alabama, Inc., f/k/a Norwest Financial – Athens; made similar consumer loans; required arbitration agreement;

7. Compass Bank – Athens;

8. Badcock Home Furnishing Center – Athens; did not make similar loans secured by personal property;

9. First South Agricultural Credit Association (formerly First South Production Credit) – Athens; did not make similar loans secured by personal property;

10. First Trust Mortgage of Athens;

11. First State Loans – Athens; made similar consumer loans; required arbitration agreement;

12. Alabama Money – Athens; made similar consumer loans; required arbitration agreement;

13. First Southern United Financial Services – maintained an office in Athens until June 1999; made similar consumer loans; did not routinely require arbitration agreement;

14. First Commercial Bank of Huntsville; made similar consumer loans; did not routinely require arbitration agreement;

15. South Bank – Huntsville; made similar consumer loans; did not routinely require arbitration agreement;

16. North Alabama Bank--Huntsville and Hazel Green locations; made similar consumer loans; did not routinely require arbitration agreement;

17. Heritage Bank – Huntsville and Decatur locations; made similar consumer loans; did not routinely require arbitration agreement;

18. Family Security Credit Union – Decatur, Hartselle, And Athens Locations; Made Similar Consumer Loans; Did Not Routinely Require Arbitration Agreement; Mrs. Ashby Was Not And Is Not A Member Of The Credit Union And Would Have Had To Join Credit Union To Apply For A Loan;

19. Regions Bank – Athens; made similar consumer loans; routinely required arbitration agreement;

20. First American Bank – Athens; made similar consumer loans; did not routinely require arbitration agreement;

21. Reliance Bank – Athens; made similar consumer loans; did not routinely require arbitration agreement;

22. Union Planters Bank – Hartselle and Athens branches; made similar consumer loans; routinely required arbitration agreement.

The record reveals that Compass Bank (no. 7) and First Trust Mortgage of Athens (no. 10) were listed under the category "financing" in the 1999 Athens BellSouth telephone directory. Although the record does not contain evidence regarding the lending practices of either of those lenders, they are included on the above list for the purpose of making the list complete.

BROWN, Justice (concurring in part and dissenting in part).

I disagree with the portion of the majority opinion that holds that the arbitration agreement included in the note and security agreement between American General Finance and the Ashbys is unconscionable and therefore unenforceable.

First, I do not believe that the terms of the arbitration agreement, when considered either singly or as a whole, are unconscionable. Although this Court has held that "agreements to arbitrate are not in themselves unconscionable," *Ex parte McNaughton*, 728 So. 2d 592, 598 (Ala. 1998), I believe that the majority opinion impermissibly "single[s] out the provisions of [the] arbitration agreement[ ] for suspect status" and places the arbitration agreement on a different footing from other contracts. *Harris v. Green Tree Fin. Corp.*, 183 F.3d 173, 183 (3d Cir. 1999). See also *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996) (noting that in enacting the Federal Arbitration Act, "Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed 'upon the same footing as other contracts.'" (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 (1974)); *Green Tree Fin. Corp. of Alabama v. Wampler*, 749 So. 2d

409, 416-17 (Ala. 1999) ("we are not at liberty to treat arbitration agreements as inherently unfair or oppressive" (citing *McNaughton* and *Coleman v. Prudential Bache Sec., Inc.*, 802 F.2d 1350, 1352 (11th Cir. 1986), following *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983))).

Moreover, I dissented in *American General Finance, Inc. v. Branch*, 793 So. 2d 738 (Ala. 2000), because in that case, as here, there was not a shred of evidence indicating that, before the plaintiff signed the arbitration agreement, she attempted to locate a lender that did not require the execution of an arbitration agreement in conjunction with a loan, and there was no evidence indicating that the plaintiff had attempted to negotiate with the defendant a contract that did not include an arbitration agreement. See *Branch,* 793 So. 2d at 752 n.6 (Hooper, C.J., concurring in the result in case 1990888, but dissenting in case 1990887).

STUART, Justice (concurring in part and dissenting in part).

I concur with the per curiam opinion except for two aspects: I dissent from the holding that Mrs. Ashby, without presenting evidence that she and Mr. Ashby actually shopped around in an attempt to secure an arbitration-free loan, has established that they had no meaningful choice but to accept the arbitration provision offered by American General Finance. I also dissent from the holding that this Court need not apply the severability provision found in the arbitration agreement.

I conclude that the "hindsight" evidence offered by Mrs. Ashby is insufficient to establish that the Ashbys lacked a meaningful choice in whether to accept the arbitration provision contained in American General Finance's note and security agreement. Mrs. Ashby testified that she and Mr. Ashby

wanted to do business with American General Finance for two reasons: American General Finance made the process easy for them and American General Finance would provide Mr. Ashby with credit-life insurance. The record does not indicate that the Ashbys consulted with any other lender before deciding to do business with American General Finance.

It appears that this Court did not require the plaintiff in *Branch* to offer evidence showing that, before she obtained the loan in question she had actually shopped for but was unable to find or obtain an arbitration-free loan in order to establish that she had no meaningful choice in obtaining such a loan. However, since *Branch*, we have released at least two opinions that stand for the proposition that a plaintiff must offer such evidence. See *Vann v. First Community Credit Corp.*, 834 So. 2d 751 (Ala. 2002) (plaintiffs who challenged an arbitration provision as unconscionable failed to present evidence indicating that they were unable to find an alternate lender or that the automobile dealer required them to use a lender who required an arbitration provision); and *Green Tree Fin. Corp. v. Lewis*, 813 So. 2d 820 (Ala. 2001) (buyer of a manufactured home challenged as unconscionable the arbitration provision contained in his purchase contract; this Court held that the provision was not unconscionable because, among other things, the buyer did not show that he had attempted to shop around for financing that did not require arbitration).

These cases properly apply the "no meaningful choice" language from *Branch*. If these cases conflict with the evidentiary standard created in *Branch*, which the per curiam opinion interprets as allowing a plaintiff to present after-the-fact evidence of market conditions, I would overrule *Branch* to the extent they do so. I find it objectionable to invalidate a contract provision under the guise of a consumer's having "no meaningful choice" as to that provision, if the consumer never attempted to determine what choices were available at

the time he or she accepted that contract provision. If a consumer is concerned as to whether a contract contains an arbitration provision, surely the customer would attempt to negotiate an arbitration-free contract or would shop around for such a contract.

The per curiam opinion allows a consumer to challenge the enforceability of an arbitration provision by offering evidence that arbitration-free loans were unavailable.[11] However, the per curiam opinion goes further, allowing a consumer to raise this challenge although the consumer learned that arbitration-free loans were unavailable only after the legal dispute had already arisen. Thus, the per curiam opinion allows a consumer to challenge the enforceability of an arbitration provision, based on a lack of the availability of other options, although this lack of other options did not influence the consumer to accept the arbitration provision in the first place. I find this practice unacceptable.

I would hold that for a consumer to establish that he or she lacked a meaningful choice in whether to accept an arbitration provision in his contract, the consumer must present evidence tending to show that, before entering into the contract at issue, he or she actually shopped for an arbitration-free contract but was unable to locate such a contract. I, therefore, dissent from the holding in the per curiam opinion that, to invalidate the arbitration agreement, the Ashbys, before entering into the loan at issue, need not have actually shopped for an arbitration-free loan.

I also dissent from the holding in the per curiam opinion that we need not attempt to apply the severability language

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[11] I am not certain that Mrs. Ashby proved this. Evidence was presented that arbitration-free loans were available, although arbitration-free loans that also provided credit-life insurance may not have been available to the Ashbys.

found in the American General Finance arbitration agreement. I agree that the arbitration agreement contains terms that are grossly favorable to American General Finance; the parties, however, agreed that such terms, if found by a court to be unconscionable, would be severed from the remainder of the agreement. Rather than simply hold the entire arbitration agreement unconscionable, I would strike the unconscionable provisions and attempt to enforce the remainder of the parties' agreement to arbitrate, if possible.

I also feel compelled to address Mrs. Ashby's claim that she is unable to read and that Mr. Ashby was unable to read and, therefore, that they were forced to rely upon Anderson to "explain" the documents to them, i.e., to explain that the documents contained arbitration agreements. I find this claim problematic for two reasons.

First, the Ashbys were not so unsophisticated that were unable to shop around for a lender willing to provide the credit-life option they desired. Mrs. Ashby testified that she and Mr. Ashby did not want to do business with Regions Bank because they did not believe that Regions Bank would provide Mr. Ashby with credit-life insurance. Despite their limited reading abilities, the Ashbys were clearly sophisticated enough to determine which terms and which provisions of a loan were important to them and to find a lender willing to offer those terms and provisions.

Second, the Ashbys sought to enter into a legally binding contract. However, under the law of Alabama, a person who signs a contract is deemed to know and understand the contents of that document. We applied this legal principle in *Mason v. Acceptance Loan Co.*, [Ms. 1010563, Sept. 27, 2002] __ So. 2d __ (Ala. 2002), to plaintiffs who were illiterate and mentally handicapped. In that case, we held that the plaintiffs' illiteracy and mental retardation did not relieve them of their obligation to read or to inquire as to the con-

tents of the contracts they were signing.[12] We should apply the same standard in this case.

Nor do I believe that a request from an illiterate person for a generic "explanation" of a contract should be sufficient to trigger a fiduciary relationship in a typical consumer transaction, which is essentially what the per curiam opinion holds. Without a specific inquiry from the consumer, what constitutes an adequate explanation, and who decides when that explanation has been adequately understood by the contracting person? If a party wishes to enter into a contract but is unable to read the terms of that contract for himself, does he not have some obligation to have the terms of that contract read to him so that he can decide if he understands those terms and if they are acceptable? Otherwise, we allow illiterate persons to enter into legally binding contracts, but then to disclaim any knowledge or understanding of those provisions to which, in hindsight, they no longer wish to be bound.

SEE, Justice (concurring in the result in part and dissenting in part).

I concur in part in the result reached in Part I of the "Analysis" section of the per curiam opinion; I concur in the result in Part III of that section, and I dissent from the holding in Part II that the arbitration clause in the note and security agreement is unconscionable.

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[12] The plaintiffs in *Mason* alleged that they asked what they were signing and that the defendant told them only that the documents were "loan papers and insurance papers," but did not specifically mention the arbitration agreements. *Mason,* __ So. 2d at __. This Court concluded that the plaintiffs' claim was one alleging fraudulent inducement directed at the entire contract and thus should be resolved by the arbitrator. *Id.*

Mrs. Ashby seeks to avoid performance under arbitration agreements in a note and security agreement ("loan agreement") she and Mr. Ashby entered into with American General Finance and in the credit-life insurance application Mr. Ashby submitted to Merit Life Insurance Company in connection with the Ashbys' loan from American General Finance. Mrs. Ashby alleges that the arbitration agreement in the loan agreement is unconscionable and that Merit Life fraudulently procured Mr. Ashby's agreement to the stand-alone arbitration agreement signed in conjunction with the insurance application by concealing from him the arbitration agreement that was part of the credit life-insurance application. I agree with the per curiam opinion that insofar as Mrs. Ashby alleges that the Ashbys' agreements to arbitrate their dispute with American General Finance and Merit Life are void due to fraud, it was proper for the trial court to decide the gateway questions of arbitrability; and I agree that, to the extent the determination of that question requires answers to questions of material fact, a jury should decide whether Merit Life fraudulently obtained Mr. Ashby's agreement to arbitrate disputes that might arise between him and Merit Life. *See Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, __, 123 S. Ct. 588, 592 (2002) ("a gateway dispute about whether the parties are bound by a given arbitration clause raises a 'question of arbitrability' for a court to decide"). Whether Mrs. Ashby must arbitrate her dispute with Merit Life depends on whether Merit Life did or did not fraudulently procure Mr. Ashby's assent to the arbitration clause in the credit-life insurance application.

The Fraud in the Factum Claim Against Merit Life

Mrs. Ashby has a fourth-grade education and can read only simple words. Mr. Ashby, who is now deceased, was illiterate. Mrs. Ashby stated that she and Mr. Ashby asked Michael Anderson, the agent for American General Finance

and Merit Life, to explain to them the various documents associated with the loan before they agreed to the transaction. The trial court found that Mrs. Ashby had established a fraud in the factum defense because Anderson had described the freestanding arbitration agreement that he presented to Mr. Ashby as a contract of insurance and not as an arbitration agreement.

The issue presented is whether, as a matter of law, an illiterate person who signs an agreement to purchase credit-life insurance in which an arbitration clause is a material term can maintain an action against the insurance company for fraud in the factum (and avoid performance under the arbitration clause) when the agent who explained the material terms of the insurance agreement to the illiterate person described the portion of the insurance agreement containing an arbitration clause simply as insurance papers and not as a binding arbitration agreement.

Fraud in the factum occurs when "'a misrepresentation as to the character or essential terms of a proposed contract induces conduct that appears to be a manifestation of assent by one who neither knows nor has a reasonable opportunity to know of the character or essential terms of the proposed contract * * *.'" *Harold Allen's Mobile Home Factory Outlet, Inc. v. Early*, 776 So. 2d 777, 783 n.6 (Ala. 2000) (quoting *Restatement (Second) of Contracts* § 163 & cmt. a (1981)).[13]

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[13] " ' "[A] person who signs an instrument without reading it, when he can read, can not, in the absence of fraud, deceit or misrepresentation, avoid the effect of his signature, because [he is] not informed of its contents; *and the same rule [applies] to one who can not read, if he neglects to have it read, or to enquire as to its contents.*" ' "

Johnnie's Homes, Inc. v. Holt, 790 So. 2d 956, 960 (Ala. 2001) (quoting *Mitchell Nissan, Inc. v. Foster*, 775 So. 2d 138, 140 (Ala. 2000), quoting in turn *Beck & Pauli Lithographing Co. v. Houp-*

A "determination of whether a term is [an] essential [term] must be done with respect to the contract and the particular circumstances in each case." *Conner v. Lavaca Hospital Dist.*, 267 F.3d 426, 434 (5th Cir. 2001). Generally, "[t]he essential terms of an insurance contract are the rate of premium, the duration of the policy, the nature of the risk, a description of the property or person or interest to be insured and its location, and the amount of the insurance." *Gulf Gate Mgmt. Corp. v. St. Paul Surplus Lines Ins. Co.*, 646 So. 2d 654, 658 (Ala. 1994). An insurance agent ordinarily would not commit fraud in the factum if the agent explained or read an insurance contract to an illiterate person and omitted a discussion of an arbitration agreement, because such an agreement is not an essential element in an insurance contract. [14]

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pert & Worcester, 104 Ala. 503, 506, 16 So. 522, 522 (1894)) (emphasis added in *Mitchell Nissan*).

> "'Where [however] there exists this total incapacity to read and understand a writing, then the normal duty to do so is excused and a fraud case is made out by showing that the other party misrepresented the contents of the writing.'"

Alfa Mutual Ins. Co. v. Northington, 561 So. 2d 1041, 1049 (opinion on application for a rehearing) (Houston, J., concurring specially) (quoting Morris G. Shanker, *Judicial Misuses of the Word Fraud to Defeat the Parol Evidence Rule and the Statute of Frauds (With Some Cheers and Jeers for the Ohio Supreme Court)*, 23 Akron L. Rev. 1 (1989)).

[14] This Court has previously stated that the inclusion of an arbitration clause does not materially alter an insurance policy; "'[e]ven if the inclusion of the arbitration provision was a material alteration of the policy applied for – and we would say it was not * * *.'" *American Bankers Ins. Co. of Florida v. Crawford*, 757 So. 2d 1125, 1130 (Ala. 1999) (quoting *Ex parte Rager*, 712 So.2d 333, 336 (Ala. 1998)). This Court also has found that a merchant has no general duty to "disclose, or explain, an arbitration clause to

However, Mrs. Ashby alleges that in this case Anderson characterized the arbitration agreement as "insurance papers." If Anderson engaged in such an active mischaracterization of the arbitration agreement, that conduct is compelling evidence that Merit Life considered the arbitration agreement an essential element in the insurance contract; therefore, Merit Life may be estopped to deny that the arbitration agreement is an essential element and would have been required to disclose the agreement to the Ashbys.

There is other evidence indicating that Merit Life considered the arbitration agreement an essential element.

> "In determining whether a term is an essential element of a contract, we look at whether a party's rejection of the term[ ] could have affected the negotiation of other terms * * * '[A]n "essential" promise denotes one that the parties reasonably regarded, at the time of contract, as a vitally important part of the bargain * * *.'"

Conner, 267 F.3d at 433 (citations omitted). Merit Life stated in its brief to this Court that Anderson, its agent, presented to Mr. Ashby, along with the insurance application, "a separate agreement containing the bold and capitalized words 'arbitration of claims and waiver of jury trial.'" Merit required Mr. Ashby not only to sign the insurance application but also to sign the arbitration agreement. By these actions – identifying the arbitration agreement with bold capitalized letters, presenting the arbitration agreement as a separate document, requiring that Mr. Ashby sign the arbitration agreement as well as the insurance application – Merit Life indicated that the arbitration clause was an essential element in its insurance contract with the Ashbys. Thus, Merit Life considered the agreement to arbitrate disputes an essential

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a buyer." *Johnnie's Homes, Inc. v. Holt*, 790 So. 2d 956, 960 (Ala. 2001).

element in the credit-life insurance agreement and created for itself a duty to disclose and to explain the arbitration clause when Mr. Ashby asked Anderson to read and explain the loan and insurance documents.

I concur with the holding of the per curiam opinion that Mrs. Ashby may maintain, as a matter of law, a fraud in the factum claim against Merit Life.

Trial Court's Consideration of Arbitrability and Unconscionablity

Mrs. Ashby argues that she is not required to arbitrate her dispute with American General Finance because, she argues, the arbitration clause in the loan agreement is unconscionable. The arbitration clause in the loan agreement states, in part: "[b]orrower(s) and [American General Finance] agree that, except as otherwise set forth in this provision, all claims, disputes, or controversies of every kind and nature between Borrower(s) and Lender shall be resolved by arbitration"; the agreement also states that "[b]orrower(s) and Lender further agree that all issues and disputes as to the arbitrability of claims must also be resolved by the arbitrator." American General Finance argues that not only does the loan agreement require Mrs. Ashby to arbitrate her dispute, but it also requires that any issues concerning the arbitrability of the dispute and the unconscionability of the arbitration clause be resolved by an arbitrator.

The per curiam opinion finds that the issues presented in this case are virtually identical to those presented in *American General Finance, Inc. v. Branch*, 793 So. 2d 738 (Ala. 2000). The arbitration clause at issue in *Branch* required the parties to submit to an arbitrator any dispute as to arbitrability. Branch argued that she could not be compelled to arbitrate her dispute because, she said, the arbitration clause was unconscionable. Chief Justice Hooper dissented in *Branch* because he believed the presence of the clause requiring that

disputes about arbitrability be submitted to an arbitrator required the Court to treat the arbitrability question and the unconscionability question as distinct issues, and he believed the issue of arbitrability was to be submitted to the arbitrator.[15] 793 So. 2d at 753-54. I also dissented in *Branch*. I believed that Branch had not demonstrated that she had no meaningful choice with respect to the arbitration provision. 793 So. 2d at 754.

In *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995), the Supreme Court of the United States held that "the question, 'who has the primary power to decide arbitrability' turns upon what the parties agreed about *that* matter" (emphasis in original). If the parties agreed in the arbitration agreement that the arbitrator shall decide questions of arbitrability – what is called a *First Options* clause – then with the exception of whether the parties actually agreed to a *First Options* clause, an arbitrator should decide all questions of procedural and substantive arbitrability. *See Howsam v. Dean Witter Reynolds, Inc.*, supra. The Supreme Court has stated:

> "[O]ne might call any potentially dispositive gateway question a 'question of arbitrability' * * *. The Court's case law, however, makes clear that, for purposes of applying the interpretive rule [of what constitutes a threshold issue for judicial determination], the phrase 'question of arbitrability' has a far more limited scope. The Court has found the phrase applicable in the kind of narrow circumstance where contracting parties would likely have expected a court to have decided the gateway matter, where they are not likely to have thought that they had agreed that an arbitrator would do so, and, consequently, where reference of the gateway dispute to the court

[15] By implication, the arbitrator would then decide whether the agreement was unconscionable.

> avoids the risk of forcing parties to arbitrate a matter that they may well not have agreed to arbitrate."

Howsam, 537 U.S. at __, 123 S. Ct. at 592 (citation omitted). The Supreme Court of the United States also has held that even when an ambiguous contractual provision is susceptible of constructions that may cast doubt on the enforceability of the arbitration agreement itself, such a contractual ambiguity does not raise the type of "'gateway' question of arbitrability * * * appropriate for a court to answer * * * in the first instance," but instead is the type of question to be decided by an arbitrator. *PacifiCare Health Sys., Inc. v. Book*, __ U.S. __ n.2, 123 S. Ct. 1531, 1531 n.2 (2003) (holding that the question as to whether a remedial limitation clause in a contract prohibits an award of treble damages under the Racketeer Influenced and Corrupt Organizations Act is not a question of arbitrability for a court to decide, but is itself a question to be decided by the arbitrator).[16]

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[16] In *PacifiCare*, a group of physicians sued PacifiCare and United Healthcare, Inc., alleging, among other things, claims under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1961 *et seq.* PacifiCare moved to compel arbitration under various arbitration agreements contained in its contracts with the physicians. The arbitration agreements prohibited an arbitrator from making an award of punitive damages. The physicians argued that the arbitration agreements were unenforceable under *Paladino v. Avnet Computer Technologies, Inc.*, 134 F.3d 1054, 1062 (11th Cir. 1998) (holding that where a remedial limitation in an arbitration agreement prevents a plaintiff from obtaining "meaningful relief" for a statutory claim, the agreement to arbitrate is unenforceable with respect to that claim), because the bar to punitive damages would prevent them from obtaining meaningful relief on their RICO claims. The Supreme Court of the United States agreed that the arbitration agreements might be unenforceable if the punitive-damages bar denied the physicians meaningful relief as to their RICO claims, but the Supreme Court held that a

If parties to a dispute have previously agreed to an arbitration agreement that itself contains a *First Options* clause, if one of the parties contests in court the arbitrability of the dispute, the only issue properly before the trial court is whether the parties unmistakably agreed to the *First Options* clause. *See Ex parte Perry*, 744 So. 2d 859, 867 (Ala. 1999). Of course, when the trial court considers whether parties have agreed to arbitrate the question of arbitrability, it should "apply ordinary state-law principles that govern the formation of contracts." *First Options*, 514 U.S. at 944.

Generally, "[c]ontract defenses that are * * * applicable under state law, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements * * *." *Ex parte Perry*, 744 So. 2d at 869 (Lyons, J., dissenting). In the case of a *First Options* clause, however, the only relevant state-law issue is "whether the parties objectively revealed an intent to submit the arbitrability issue to arbitration." *First Options*, 514 U.S. at 944.

Moreover, a court may not find a clause that requires an arbitrator to decide issues of arbitrability unconscionable on its face, because to do so would be invalidating an arbitration provision based on state law "applicable only to arbitration provisions," in violation of the rule set out in *Doctor's Asso-*

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court should not decide whether the dispute was arbitrable based on the mere possibility that an arbitrator might decide that the punitive-damages bar would prevent an award of RICO damages. The Supreme Court found that RICO damages might be punitive or they might be remedial; therefore, the punitive-damages limit in the arbitration agreements may or may not render the agreements unenforceable as to the RICO claims. The Supreme Court concluded that the arbitrator, and not the court, should determine what the damages limitation in the arbitration agreement meant and whether the arbitration agreement was enforceable. *PacifiCare Health Sys.*, __ U.S. __, 123 S. Ct. 1531.

ciates, Inc. v. Casarotto, 517 U.S. 681, 687 (1996). A court holding that a *First Options* clause is unconscionable would be holding that an arbitration clause is unconscionable merely for requiring the parties to submit an aspect of their dispute to arbitration.[17]

In this case, the trial court properly considered the fraud in the factum issues because those issues go to whether the Ashbys agreed to arbitrate their dispute with American General Finance and Merit Life. Because the arbitration agreement in this case contains a *First Options* clause, the trial court erred when it considered the question whether the arbitration clause in the loan agreement was unconscionable. Once the trial court considered two threshold issues – whether the arbitration agreement contained a *First Options* clause and whether the *First Options* clause was obtained by fraud or duress – all other issues of arbitrability should have been decided by an arbitrator.

The per curiam opinion accepts the language from *Branch* that states, " ' "[w]here the attack is addressed to the arbitration clause itself, as opposed to the contract as a whole, the court, and not the arbitrator resolves the issue." ' " __ So. 2d at __ (quoting *Branch*, 793 So. 2d at 748, quoting in turn *Green Tree Fin. Corp. v. Wampler*, 749 So. 2d 409, 413 (Ala. 1999)). The per curiam opinion fails properly to distinguish between Mrs. Ashby's argument that the Ashbys never agreed to arbitrate their dispute because they were not aware of the arbitration agreements (the fraud in the factum claim) and Mrs. Ashby's argument that the arbitration

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[17] Insofar as the Supreme Court of the United States recognized in *Howsam* that parties may agree to arbitrate "issues of substantive arbitrability," 537 U.S. at __, 123 S. Ct. at 592, and that such agreements would remove those issues from the province of the trial court, the Supreme Court has indicated that such clauses are not on their face unconscionable.

agreement included in the loan agreement is unconscionable. Moreover, Mrs. Ashby does not allege that the *First Options* clause itself is unconscionable.[18] Therefore I dissent from those portions of Part I and Part II of the "Analysis' section of the per curiam opinion that hold that it was proper for the trial court to consider the unconscionability issue.

The Unconscionability Claim

The per curiam opinion holds that the arbitration agreement in the loan agreement is unconscionable because its terms are grossly favorable to American General Finance and because the Ashbys had no meaningful choice in obtaining an arbitration-free loan. This Court has held that "agreements to arbitrate are not in themselves unconscionable." *Ex parte McNaughton*, 728 So. 2d 592, 598 (Ala. 1998).

> "'An unconscionable * * * contractual provision is defined as a * * * provision "such as no man in his sense and not under delusion would make on the one hand, and as no honest and fair man would accept on the other." ' " *Southern United Fire Ins. Co. v. Howard*, 775 So. 2d 156, 163 (Ala. 2000) (quoting *Layne v. Garner*, 612 So. 2d 404, 408 (1992)). In *Branch,* this Court suggested that unconscionability consists of "two essential elements: (1) terms that are grossly favorable to a party that has (2) overwhelming bargaining power." 793 So. 2d at 748.[19]

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[18] Mrs. Ashby argues that the inclusion of a *First Options* clause in an arbitration agreement may, in certain contexts, be an indicium that the entire arbitration clause is unconscionable. (Ashby's brief at 30.) Mrs. Ashby does not argue, however, that a *First Options* clause is per se unconscionable.

[19] In this case, the applicable doctrine of unconscionability is that codified at § 5-19-16, Ala. Code 1975. Alabama's version of the Uniform Commercial Code, § 7-2-302, Ala. Code 1975, presents the unconscionability doctrine applicable to the sales of goods.

The official comment to § 7-2-302, Ala. Code 1975, states, in pertinent part:

> "The basic test [of unconscionability] is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract * * *. The principle is one of the prevention of oppression and unfair surprise * * * and not of disturbance of allocation of risks because of superior bargaining power."

See also In re State of New York v. Avco Fin. Serv. of New York, 406 N.E.2d 1075, 1078 ("The concept, at least as defined in the Uniform Commercial Code * * * is not aimed at 'disturbance of allocation of risks because of superior bargaining power' but, instead, at 'the prevention of oppression and unfair surprise.'").

"[U]nconscionability as set forth in UCC § 2-302 is 'not a concept, but a determination to be made in light of a variety of factors not unifiable into a formula.'" *NEC Techs., Inc. v. Nelson*, 478 S.E.2d 769, 771 (1996) (quoting 1 White & Summers, *Uniform Commercial Code* (4th ed.), § 4-3, p. 213). Unconscionability consists in procedural and substantive elements. *NEC Technologies,* 478 S.E.2d at 771. "As to the substantive element of unconscionability, courts have focused on matters such as the commercial reasonableness of the contract terms, the purpose and effect of the terms, the allocation of the risks between the parties, and similar public policy concerns." *NEC Technologies*, 478 S.E.2d at 772. "'The procedural element focuses on two factors: "oppression" and "surprise." * * * "Surprise" involves the extent to which the supposedly agreed-upon terms of the bargain are hidden in a prolix printed form drafted by the party seeking to enforce the disputed terms.'" *Mullis v. Speight Seed Farms, Inc.*, 505 S.E.2d 818, 820-21 (1999) (quoting *A & M Produce Co. v. FMC Corp.*, 135 Cal. App. 3d 473 (1982)).

> "The UCC does not require that there be complete equality of bargaining power or that the agreement be equally beneficial to both parties * * *.

The per curiam opinion states in conclusory terms that the arbitration agreement is overwhelmingly favorable to American General Finance because: (1) the agreement is too broad; (2) the agreement provides that the arbitrator shall consider questions of arbitrability;[20] (3) the agreement lacks mutuality of remedies; and (4) the agreement limits recovery of punitive damages to five times any economic damages. __ So.2d at __.

None of these issues, considered individually, provide grounds to find the arbitration clause unconscionable. Courts routinely support arbitration in cases involving broad arbitration clauses. *See, e.g., Pritzker v. Merrill Lynch, Pierce Fenner & Smith*, 7 F.3d 1110, 1114 (3d Cir. 1993) (upholding an arbitration agreement that required "all controversies which

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> "The cases seem to support the view that there must be additional factors such as deceptive bargaining conduct as well as unequal bargaining power to render the contract between the parties unconscionable. In summary, the doctrine of unconscionability is used by the court to police the excesses of certain parties who abuse their right to contract freely. It is directed against one-sided, oppressive and unfairly surprising contracts, and not against the consequences per se of uneven bargaining power or even a simple old-fashioned bad bargain."

Wille v. Southwestern Bell Tel. Co., 549 P.2d 903, 907 (1976). Moreover, a court will not "relieve a party of his obligations under a contract because he has made a bad bargain containing contractual terms which are unreasonable or impose an onerous hardship on him." *Fotomat Corp. of Florida v. Chanda*, 464 So. 2d 626, 630 (Fla. Dist. Ct. App. 1985) (citing *Steinhardt v. Rudolph*, 422 So. 2d 884, 890 (Fla. Dist. Ct. App. 1982)).

[20] *Branch* cited only Justice Lyons' special writing concurring in the result in *Brilliant Homes, Ltd. v. Lind*, 722 So. 2d 753, 755 (Ala. 1998), as authority for the proposition that "the provision purporting to invest the arbitrator with threshold issues of arbitrability" is an indicium of unconscionability. 793 So. 2d at 749.

may arise between us, including but not limited to, any transaction or the construction, performance or breach of this or any other agreement between us, whether entered into prior, on or subsequent to the date hereof, shall be determined by arbitration"); *Bess v. Check Express*, 294 F.3d 1298, 1308 (11th Cir. 2002) (upholding an arbitration clause where "the arbitration agreement here, like that in [*American General Finance, Inc. v.] Branch*,[793 So. 2d 738 (Ala. 2001)], is unusually broad");[21] *Dean Witter Reynolds, Inc. v. McDonald*, 758 So. 2d 539, 540 (Ala. 1999) (upholding an arbitration clause that required arbitration in "all controversies between me or my agents and you or your agents, representatives or employees arising out of or concerning any such accounts, any transactions between us or for such accounts, or the construction, performance, or breach of this or any other agreement between us, whether entered into prior to, on or subsequent to the date below * * *."). A broad arbitration clause merely indicates that parties have agreed to adjudicate their entire dispute in an arbitral forum.

A clause that requires parties to submit a dispute about the arbitrability of their dispute to the arbitrator cannot be unconscionable.[22] To hold otherwise would impermissibly "single out the provisions of arbitration agreements for suspect status," *Harris v. Green Tree Fin. Corp.*, 183 F.3d 173, 183 (3d Cir. 1999), and place such agreements on a different "footing [from] other contracts." 183 F.3d at 183. "Courts may not * * * invalidate arbitration agreements under state

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[21] The United States Court of Appeals for the Eleventh Circuit also in *Bess* distinguished the arbitration clause at issue from that in *Branch* because it did not contain a limit on punitive damages and did not require the parties to submit questions about arbitrability to the arbitrator. 294 F.3d at 1308.

[22] "[A]greements to arbitrate are not in themselves unconscionable." *Ex parte McNaughton*, 728 So. 2d at 598.

laws applicable *only* to arbitration provisions." *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996). A rule that states it is unconscionable for parties to agree to submit disputes about arbitrability to an arbitrator is a rule that necessarily applies only to arbitration clauses and therefore runs afoul of the holding in *Doctor's Associates*.

A lack of mutuality of remedy will not render an arbitration clause unconscionable.

> "[P]roperly understood, the concept of mutuality of remedy has no application to arbitration agreements * * *.
>
> "The doctrine of mutuality of remedy is limited to the availability of the ultimate redress for a wrong suffered by a plaintiff, not the means by which that ultimate redress is sought. A plaintiff does not seek as his ultimate redress an arbitration proceeding or a court proceeding. Instead, he seeks legal relief (e.g., damages) or equitable relief (e.g., specific performance) for his injury and he uses the proceeding as a means to obtain that result."

McNaughton, 728 So. 2d at 598.[23] "In any event, the lack of mutuality of remedy, alone, is not sufficient to support a claim of unconscionability." *Vann v. First Community Credit Corp.*, 834 So. 2d 751, 754 (Ala. 2002). *See also Mason v. Acceptance Loan Co.*, [Ms. 1010563, Sept. 27, 2002] __ So.2d __, __ (Ala. 2002) (stating that a lack of mutuality of remedy "cannot *alone* be determinative" of unconscionability); *Green Tree Fin. Corp. of Alabama v. Wampler*, 749

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[23] In this case, the arbitration agreement permits American General Finance to seek a judicial remedy to secure only its security interest (or what might be considered its economic damages), while Mrs. Ashby is limited to seeking a remedy in arbitration that includes all of her economic damages (in whatever amount), and an award of punitive and other damages that totals no more than five times her economic damages.

So. 2d 409, 417 (Ala. 1999) ("We simply cannot declare a violation of public policy when one party is required to arbitrate while the other retains a choice."); *Willis Flooring, Inc. v. Howard S. Lease Constr. Co. & Assocs.*, 656 P.2d 1184, 1186 (Alaska 1983) ("Arbitration is not so clearly more or less fair than litigation that it is unconscionable to give one party the right of forum selection.").

Finally, limitations on the damages a party may recover do not make an arbitration clause unconscionable. As I stated in my dissent in *Cavalier Manufacturing, Inc. v. Jackson*, 823 So. 2d 1237, 1252 (Ala. 2001) (See, J., dissenting): "The weight of authority supports the conclusion that the parties to an arbitration agreement are free to agree that an arbitrator may not award punitive damages." *See also, Baravati v. Josephthal, Lyon & Ross, Inc.*, 28 F.3d 704, 709 (7th Cir. 1994) ("parties to adjudication have considerable power to vary the normal procedures, * * * and surely can stipulate that punitive damages will not be awarded"); *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378, 1387 n.16 (11th Cir. 1988) (noting that a "clear provision in a contract prohibiting arbitrators from awarding punitive damages" would be enforceable); *Davis v. Prudential Sec., Inc.*, 59 F.3d 1186, 1192 n.6 (11th Cir. 1995) ("Presumably, therefore, even after the Supreme Court's decision in *Mastrobuono [v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995)], parties wishing to avoid the imposition of punitive damages in arbitration may simply expressly exclude punitive damages in the arbitration agreement."). I also note that if the parties litigate their dispute in court, Alabama law limits punitive damages to three times actual damages; thus, the per curiam opinion holds unconscionable – or, at least, considers as a factor in finding an agreement unconscionable as against the defendant – that the defendant allows a punitive-damages award against him that

is greater than that permitted by the Legislature. *See* § 6-11-21(a), Ala. Code 1975.[24]

The per curiam opinion in this case does not explain why these four elements, each of which considered singly is permissible, operating together somehow make the agreement unconscionable. In *Branch*, the Court explained that these elements operating together were grossly favorable to the lender because "the Lenders have reserved for themselves the right to *full redress* for *their* claims, but denied that right to Branch. In other words, the contract limits not only the right to a specific *forum,* but the *right to a remedy itself.*" 793 So. 2d at 750. The Court's rationale in *Branch* "assigns a suspect

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[24] The Supreme Court of the United States' reasoning in *State Farm Mutual Automobile Insurance Co. v. Campbell*, __ U.S. __, (2003), which like this case is a bad-faith case against an insurance company, suggests that a clause limiting the amount of punitive damages to no more than five times the amount of economic damages is not unconscionable as a limit on the amount of punitive damages that may be awarded. The Supreme Court stated:

> "Our jurisprudence and the principles it has now established demonstrate, however, that, in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process. In [*Pacific Mutual Life Insurance Co. v.] Haslip*, [499 U.S. 1 (1991),] in upholding a punitive damages award, we concluded that an award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety. 499 U.S. at 23-24. We cited that 4-to-1 ration again in [*BMW of North America, Inc. v.] Gore*, 517 U.S. [559], 581 [(1996)]. The Court further referenced a long legislative history, dating back over 700 years and going forward to today, providing for sanctions of double, treble, or quadruple damages to deter and punish. *Id.* at 581, and n.33. While these ratios are not binding, they are instructive."

__U.S. at __, 123 S. Ct. at 1524.

status to arbitration agreements [and] flies in the face of *Doctor's Associates*, 517 U.S. at 687, where the Supreme Court of the United States explicitly stated that '[c]ourts may not * * * invalidate arbitration agreements under state laws applicable only to arbitration provisions.'" *McNaughton*, 728 So. 2d at 598 (alterations in original). The main opinions in *Branch* and in this case hold that the arbitration agreement in American General Finance's loan agreement is unconscionable, not because the parties agree to limit the available remedies, but because the limited remedies are to be determined in an arbitral forum in which threshold questions of arbitrability are to be determined by the arbitrator. That result is not permitted by the Federal Arbitration Act. *See Doctor's Associates*, 517 U.S. at 687. The fact that a remedy is to be determined in an arbitral forum may not make an arbitration clause unconscionable.

The per curiam opinion also finds that American General Finance possessed overwhelming bargaining power and that the Ashbys lacked a meaningful choice. American General Finance argues that Mrs. Ashby failed to present any evidence indicating that she and Mr. Ashby even attempted to shop for a loan from another company. The per curiam opinion concludes that "the trial court did not err in concluding that the arbitration agreement in the note and security agreement was unconscionable in the absence of evidence indicating that the Ashbys sought other alternatives to the American General Finance loan." __ So. 2d at __. The per curiam opinion, citing *Branch* as authority, concludes "that the Ashbys would have had to expend considerable time and effort to locate the remaining two companies * * *." __ So. 2d at __. The per curiam opinion held that American General Finance possessed overwhelming bargaining power merely because the Ashbys "'*would have had* to expend considerable effort even to find' the 1 or 2 of the 16 companies that would

not have required arbitration." __ So. 2d at __ (citing *Branch*, 793 So. 2d at 751).

I dissented in *Branch* because Branch had "presented no evidence that she shopped around before borrowing from American General." 793 So. 2d at 754 (See, J., dissenting). In both *Green Tree Financial Corp. of Alabama v. Vintson*, 753 So. 2d 497, 504 (Ala. 1999), and *Green Tree Financial Corp. v. Lewis*, 813 So. 2d 820, 825 (Ala. 2001), cases decided, respectively, before and after this Court decided *Branch*, this Court held that the borrowers, who failed to present evidence indicating that they had shopped around for a loan, had not demonstrated that they lacked a meaningful choice when presented with an arbitration clause by the lenders. I see no meaningful difference between the evidence presented in *Vintson* or *Lewis* and that presented by Mrs. Ashby. Mrs. Ashby has presented no evidence indicating that she and Mr. Ashby actually shopped for a loan agreement that did not contain an arbitration clause (or, for that matter, that they cared); therefore, I would hold that the trial court erred in finding that the Ashbys lacked a meaningful choice.

Even, however, had Mrs. Ashby presented evidence tending to show that the Ashbys had shopped for a loan, she still could have failed to present evidence tending to show that the Ashbys lacked a meaningful choice. The per curiam opinion states: "The trial court also determined, and we agree, that the Ashbys had no input into negotiating the terms of or drafting the arbitration agreement." __ So. 2d at __.

In *Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 170 F.3d 1, 17 (1st Cir. 1999), the United States Court of Appeals for the First Circuit held that an employee had failed to demonstrate that an arbitration clause in an employment contract was unconscionable, or that he lacked a meaningful choice, even though "the district court found that

signing the U-4 Form [securities dealer-registration form] was a prerequisite for employment as a securities broker * * *." The fact that every firm in the securities industry required every employee to sign the same arbitration agreement and that employees were not free to alter or remove the arbitration agreement from their employment contracts was not sufficient to demonstrate that the employee lacked a "meaningful choice" when deciding whether to sign the agreement. *See Rosenberg*, 170 F.3d at 17. The First Circuit Court of Appeals stated: "inequality in bargaining power 'is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context' * * *. Absent a showing of fraud or oppressive conduct * * * the contract is not unenforceable on these grounds." 170 F.3d at 17 (footnote omitted). Therefore, Mrs. Ashby would need to demonstrate substantially more than the fact that most lenders, or even every lender, incorporated an arbitration clause into a loan agreement before she could demonstrate that she and Mr. Ashby lacked a meaningful choice when deciding whether to sign the loan agreement.[25] Therefore, I dissent

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[25] I would imagine that every lender requires that borrowers repay their loans in full, on time, and with some interest charge. The fact that borrowers do not have a "meaningful choice" but to agree to repay loans in full, on time, and with interest does not make loan agreements unconscionable. Similarly, all loan contracts contain an express or implied forum-selection clause. For this Court to hold that an arbitration clause in a loan agreement is unconscionable merely because all lenders in some geographic area incorporate the same choice of forum clause in their loan contracts – in this case a forum-selection clause that prefers an arbitral forum – would run afoul of the express holding of the Supreme Court of the United States in *Doctor's Associates*, 517 U.S. at 687, that arbitration clauses may not be treated differently from any other contract provision; unless, that is, this Court intends to treat as unconscionable all provisions – and not just arbitration clauses – that are standard in a particular industry.

from Part II of the "Analysis" section of the per curiam opinion; I would hold that Mrs. Ashby has failed to prove that the arbitration clause in the Ashbys' loan agreement with American General Finance is unconscionable.

APPENDIX B

IN THE CIRCUIT COURT OF LIMESTONE COUNTY, ALABAMA

MARY JEAN ASHBY, as personal representative of the Estate of Jimmy Ashby, deceased, and Mary Jean Ashby, Individually

Plaintiff,

vs.

MICHAEL J. ANDERSON; American General Finance, Inc., an Alabama Corporation; Merit Life Insurance Company, et al.

Defendants.

Case # CV-00-150

ORDER

This court held a hearing on the defendants' Motion to Stay Proceedings, including discovery, and to Compel Arbitration of Plaintiffs' claims on November 9, 2000. The court held an additional hearing on said motion on June 7, 2001. Honorable David A. Elliott and Honorable Richard C. Kelley, Burr and Foreman, LLP, appeared for the defendants, and Honorable B. Scott Shipman, Sherrill, Batts and Shipman, LLC, appeared for the plaintiffs. The court considered briefs, affidavits, and documentary evidence submitted by the parties, along with live testimony by the defendant, Michael J. Anderson, the plaintiff, Mary Jean Ashby, and David Fleeting, an employee of First Family Financial Services.

FINDINGS OF FACT

Mary Jean Ashby and her husband obtained a loan from American General Finance, Inc., in Athens, Alabama using their pickup truck for collateral. Mr. and Mrs. Ashby spoke

with Michael J. Anderson, an employee of American General Finance, Inc., in regard to their loan. Prior to signing any documents, Mr. and Mrs. Ashby informed Mr. Anderson that they were unable to read and that Mr. Ashby signed his name with a mark, rather than a signature. Mr. and Mrs. Ashby specifically requested that Mr. Anderson explain the documents that they were signing.

Mr. Anderson explained to Mr. and Mrs. Ashby that they were borrowing $2,000.00, $16.50 for a title fee, and $827.10 for credit life insurance. Mr. Anderson further explained that the annual percentage rate on their loan was 23.80% and that its term loan was 36 months. Mr. Anderson also told Mr. and Mrs. Ashby that the amount of their monthly payments would be $111.27. Mr. and Mrs. Ashby agreed to purchase credit life insurance which Mr. Anderson explained would provide $5,000.00 in death benefits to Mrs. Ashby should her husband die during the term of the loan.

The court finds that Mr. Ashby was totally illiterate. The court further finds that Mrs. Ashby was functionally illiterate and could read very few words in the contracts and was incapable of understanding the contracts solely from an attempt to read it. Mr. and Mrs. Ashby lived alone except for their son who is mentally handicapped and unable to care for himself.

Mrs. Ashby testified that Mr. Anderson did not inform them that they were signing an agreement to arbitrate. Conversely, Mr. Anderson contended that he explained the arbitration agreement to Mr. and Mrs. Ashby. After hearing oral testimony on this issue, the court finds that Mr. Anderson did not inform Mr. and Mrs. Ashby that they were signing an arbitration agreement. The court notes that although Mr. Anderson testified that he obtained signatures on an Insurance Disclosure Summary, Mrs. Ashby did not remem-

ber signing the document and the defendants were unable to produce a signed copy.

Mr. Ashby died on December 1, 1999. Mrs. Ashby made a claim for death benefits upon the defendant, Merit Life Insurance Company. Her claim was denied by letter of January 31, 2000. As of the date of the hearing, Mrs. Ashby continued to make payments on the note.

PROCEDURAL HISTORY

Mary Jean Ashby, as personal representative of the estate of Jimmy Ashby, deceased, and Mary Jean Ashby, individually ("the Ashby's") filed suit against American General Finance, Inc., ("AGF"), Merit Life Insurance Company ("Merit") and Michael J. Anderson ("Anderson") (hereinafter collectively referred to as "defendants"), alleging fraud, suppression, promissory fraud, conspiracy, breach of contract, negligence and bad faith. The defendants moved this court to compel arbitration and the Ashbys filed a brief in opposition to said motion. All parties filed numerous briefs, affidavits and supporting documentation. This court held two hearings on said motion in which live testimony was presented. The defendants requested that this court withhold its ruling until the United States Supreme Court ruled on AGF's *Writ of Certiorari in American General Finance, Inc. v. Branch*, 793 So. 2d 738 (Ala. 2000). The United States Supreme Court recently denied said petition.

APPLICATION OF LAW

The United States Supreme Court, The Alabama Supreme Court and The Federal Arbitration Act require this court to apply Alabama Contract Law and defenses available thereunder to contracts requiring arbitration. In this case, the defendants moved this court to compel arbitration pursuant to the arbitration clause found in the note and security agreement provided by AGF and the separate contract of arbitration provided by Merit. The plaintiffs responded

that the AGF arbitration clause was unconscionable and that the Merit arbitration contract was procured by fraud.

Unconscionability

The defense of unconscionability must be addressed by the trial court. *Green Tree Financial Corp. v. Vintson*, 753 So. 2d 497 (Ala. 1999). The party asserting the affirmative defense of unconscionability has the burden of proof. *Green Tree Fin. Corp. v. Wampler*, 749 So. 2d 409 (Ala. 1999). The doctrine of unconscionability is codified at Ala. Code § 5-19-16 (1975), which provides:

> "With respect to a consumer credit transaction, if the court as a matter of law finds the contract or any provision of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable provision, or it may so limit the application of any unconscionable provision as to avoid any unconscionable result."

The Alabama Supreme Court set forth a two part test to be applied by this court in determining unconscionability; (1) Terms that are grossly favorable to a party that has (2) overwhelming bargaining power. *American General Finance, Inc. v. Branch*, 793 So. 2d 738 at 748 (Ala. 2000). The court notes that the arbitration clause in the note and security agreement supplied by AGF in this case is identical to that supplied by AGF in *Branch*. The Alabama Supreme Court affirmed the trial court's denial of AGF's Motion to Compel Arbitration in *Branch* because it found the arbitration clause unconscionable.

The same grossly favorable terms favoring AGF that existed in *Branch* are present here. The first indicium of unconscionability is the breadth of the clause. The *Branch* court stated that the clause applied to every cause of action that could conceivably arise in favor of Branch, and to every

individual against whom a claim could conceivably be brought. *Id.*

A second indicium of unconscionability is the provision purporting to invest the arbitrator with the threshold issues of arbitrability. The Branch court stated that "such authority of the arbitrator to determine its own authority may itself be and indicium of unconscionability." *Id* at 749, quoting *Brilliant Homes, Ltd. v. Lind*, 722 So. 2d 753 at 755 (Ala. 1998).

A third indicium of unconscionability is the provision exempting the defendants from the duty to arbitrate and expressly reserving the right to try to a jury their claims against the Ashby's up to $10,000,00. In *Branch*, the Alabama Supreme Court stated:

> "Practically speaking, this provision *benefits only the lenders*. In other words, American General reserved for itself the right to collect by *judicial action* the loan payments – the only species of claim it would ever realistically be expected to assert against Branch – while requiring Branch to settle by *arbitration* claims such as breach of contract and fraud – the species of claims she would most likely assert against the lenders." *Id.* (emphasis in original).

The AGF arbitration provisions limits the right of the arbitrator to award an amount in excess of five times the amount of economic loss. The Branch court stated this limitation includes not only punitive damages, but all species of noneconomic loss, such as mental anguish. *Id.* The Branch court found it significant that the arbitration clause prevented the borrower from obtaining the full range of relief available under Alabama Law, but allowed the lender to seek full redress for their claims in court. *Id.*

The Branch court found that the AGF arbitration provisions were so grossly favorable to the defendants as to pass

the first prong of the unconscionability test. *Id* at 750. Along with each grossly favorable term constituting an indicium of unconscionability found in the Branch case, this court finds an additional indicium of unconscionability. The Ashby's requested that the defendants explain the terms of the contract to them. The defendant's agent chose not to explain, or even mention, the arbitration clause. Such a refusal of assistance is an indicium of unconscionability. *Ex Parte Napier*, 723 So. 2d 49 at 52 (Ala. 1998).

The second prong of the unconscionability test set forth in *Branch* is overwhelming bargaining power. *American General Finance, Inc. v. Branch*, 793 So. 2d 738 at 748 (Ala. 2000). The Branch court stated that "a primary indicium of unconscionability in the modern consumer-transaction context is whether the consumer has the ability 'to obtain the product made the basis of [the] action' without signing an arbitration clause." *Id.* at 750, quoting *Green Tree Fin. Corp. v. Wampler*, 749 So. 2d 409 at 415 (Ala. 1999).

In *Branch*, the record contained stipulations and affidavit testimony of eight of the sixteen companies (the eight including AGF) that were listed in the advertising pages of the Southern Directory Company telephone directory for the City of Tuscaloosa under the heading of "financing." *Id.* Of those eight companies only one did not routinely enter into arbitration agreements in connection with its loans during the applicable time period. *Id* at 751. The *Branch* court noted that "[e]ntire segments of the market for certain goods and services * * * are being closed to consumers who are unwilling to forfeit their rights guaranteed them by the Federal and State Constitutions." *Id.*, quoting *Allstar Homes, Inc v. Waters*, 711 So. 2d 924 at 933 (Ala. 1997). The *Branch* court held that AGF possessed overwhelming bargaining power because "Branch would have had to expend considerable time and effort even to *find* [companies that

would not require arbitration]." *Id.* at 751 (emphasis in original).

In the case at hand, the record reveals that ten companies advertised under the heading "financing" in the Athens BellSouth Yellow Pages at the time that the Ashby's applied for their loan. The parties presented evidence from nine of those ten companies. Of those nine companies, three (Badcock Home Furnishing Center, First South Production Credit Association and First Trust Mortgage of Athens) did not routinely make loans to consumers using personal property as collateral – the type of loan at issue. *All* of the six remaining companies, including AGF, required arbitration agreements of their customers. The record further reveals that the defendants presented affidavits from four banks and financial institutions that did not require arbitration agreements that maintained an office in Athens, Alabama, but were not listed under "financing" in the Yellow Pages. The evidence also reveals that the Ashby's presented evidence of four such additional institutions that did require arbitration agreements. The defendants presented affidavits from companies that did not require arbitration agreements in cities other than Athens.

In order to meet their burden of proof on this issue, the Ashbys "need not show that the market was *completely* closed, only that [they were] unable to acquire goods or services without *considerable*, expenditure of time and resources." *Id.* at 751 (emphasis in original). The court concludes that the Ashbys have met this burden. The evidence reveals that the Ashbys had no input into the drafting of the note and security agreement provided by AGF. The court concludes that the evidence demonstrates that the Ashbys had no meaningful choice and that AGF had overwhelming bargaining power. As a result of the two part analysis as set forth in *Branch*, this court holds that the arbi-

tration provisions in the AGF contract is unconscionable and unenforceable.

Fraud in the Factum

The Ashbys have alleged that the arbitration provisions in the contracts were procured by fraud. Because the arbitration provision in the note and security agreement provided by AGF has been found to be unconscionable and unenforceable, the court will only address this issue in regard to the arbitration contract provided by Merit.

Just as the arbitrability of the merits of a dispute depends upon whether the parties agreed to arbitrate that dispute, the question of who shall decide arbitrability turns upon what the parties agreed about that matter. *First Options of Chicago, Inc. v. [K]aplan*, 415 U.S. 938 (1995). When deciding whether the parties agreed to arbitrate a matter, including arbitrability, this court must apply ordinary state-law principals that govern the formation of contracts. *Id.* The court must not assume that the parties agreed to arbitrate arbitrability unless there is clear and unmistakable evidence that they did so. *Id.*

The allegations by the Ashby constitute fraud in the factum or execution, as distinguished from fraud in the inducement. See *Southern Energy Homes v. Early*, 776 So. 2d 777, n.6 (Ala. June 30, 2000). The Alabama Supreme Court stated that "if a misrepresentation as to the character or essential terms of a proposed contract induces conduct that appears to be a manifestation of a assent by one who neither knows nor has reasonable opportunity to know of the character or essential terms of the proposed contract, his conduct is not effective as a manifestation of assent." *Id.* The court stated that such rare cases included situations involving illiterate persons. *Id.* Stated another way, fraud in the factum occurs when Party A procures Party B's signature to an instrument when Party B is without knowledge of its true na-

ture or contents. *Oakwood Mobile Homes, Inc. v Barger*, 773 So. 2d 454 (Ala. 2000).

Fraud in the factum constitutes ineffective assent to the contract. *Cancanon v. Smith Barney, Harris, Upham & Co.*, 805 F.2d 998 (11th Cir. 1986); *Oakwood Mobile Homes, Inc. v. Barger*, 773 So. 2d 454 (Ala. 2000). The Alabama Supreme Court has directed that "a claim of fraud in the factum is to be decided by a trial court or a jury." *Oakwood Mobil Homes, Inc. v. Burger*, 774 So. 2d 454 at 460 (Ala. 2000). The court notes that the Ashbys have demanded a jury trial in this cause. In order to present a claim of fraud in the factum to the jury, the Ashbys must present substantial evidence to support there claim of fraud in the factum.

The evidence reveals that the arbitration contract provided by Merit was a separate contract document signed only by Mr. Ashby by his mark – "X." The court further finds from the evidence that the Ashbys requested that Anderson explain the terms of the contract and that Anderson told them that the documents that they were signing provided insurance that would provide $5,000.00 in death benefits to Mrs. Ashby should Mr. Ashby die during the term of loan. Mr. Anderson was aware that the Ashbys could not read the contract and yet represented to the Ashbys that the document was a contract of insurance and not an arbitration contract. The court finds that the Ashbys have presented substantial evidence of fraud in the factum. According to Alabama Law, their claims must be resolved by a jury.

WHEREFORE IT IS ORDERED BY THE COURT that the defendants' motion to stay proceedings and compel arbitration is denied.

DONE and ORDERED this the 21 day of January, 2002.

/s/ GEORGE T. CRAIG
Circuit Judge

APPENDIX C

IN THE CIRCUIT COURT OF LIMESTONE COUNTY, ALABAMA

MARY JEAN ASHBY, as personal representative of the Estate of Jimmy Ashby, Deceased, and Mary Jean Ashby, Individually

Plaintiff,

v.

MICHAEL J. ANDERSON; American General Finance, Inc., an Alabama Corporation; Merit Life Insurance Company, et al.

Defendants.

Case No. CV-00-150

ORDER

In the above-styled matter, the Court denied Defendant's Motion to Compel Plaintiff to Arbitrate her claim against the Defendants, and the defendants filed a Motion to Alter, Amend or Vacate said Order. The Court having considered all the submissions of the parties, it is,

ORDERED, ADJUDGED and DECREED BY THE COURT that the Defendants' motion to alter, amend or vacate the Order denying defendants' motion to compel arbitration is denied.

DONE and ORDERED this the 8th day of May, 2002.

/s/ GEORGE T. CRAIG
Circuit Judge

APPENDIX D

MICHEAL J. ANDERSON, et al.

v.

MARY JEAN ASHBY, individually, and as personal representative of the estate of Jimmy Ashby, deceased.

No. 1011740

SUPREME COURT OF ALABAMA

August 29, 2003

ORDER

IT IS ORDERED that the application for rehearing filed in this cause is overruled.

Application for Rehearing Overruled.

STUART, J. – Houston, Lyons, Johnstone, Harwood, and Woodall, JJ., concur. See, Brown, and Stuart, JJ., dissent

I, Robert G. Esdale, Sr., as Clerk of the Supreme Court of Alabama, do hereby certify that the foregoing is a full, true and correct copy of the instrument(s) herewith set out as same appear(s) of record in said Court.

Witness my hand this 29th day of August, 2003.

/s/ ROBERT G. ESDALE, SR.
Clerk, Supreme Court of Alabama